

# TRANSCRIPT OF PROCEEDINGS

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IN THE MATTER OF:	)	
	)	Docket Nos.: OST-97-2881
PUBLIC HEARING ON COMPUTER	)	OST-97-3014
RESERVATION SYSTEM (CRS)	)	OST-98-4775
REGULATIONS: STATEMENT OF	)	OST-99-5888
GENERAL POLICY	)	

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## DEPARTMENT OF TRANSPORTATION

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Ballroom  
Metro Center Marriott  
725 12th Street, N.W.  
Washington, D.C.

Thursday,  
May 22, 2003

The parties met, pursuant to the notice, at  
9:06 a.m.

BEFORE: MICHAEL W. REYNOLDS  
Deputy Assistant Secretary for Aviation  
Department of Transportation

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MR. REYNOLDS: Please take your seats.

Good morning. My name is Michael Reynolds, deputy assistant secretary of transportation and international affairs.

We are holding this hearing to give  
persons an opportunity to present their  
views and to give us a chance to ask them  
questions. I would remind the speakers that this is  
an opportunity to cross-examine DOT staff.

Kim Graver will hold up a card when a

1 speaker has three minutes left, and a card when the  
2 speaker has used up his or her time.

3 More than 25 people wish to speak, so it is  
4 important that everyone keeps within their time so  
5 that all of the speakers can have the same opportunity  
6 to present their positions before the end of our  
7 ability to use this meeting room. If we have extra  
8 time, we will use it to allow additional speakers to  
9 participate.

10 We will break for lunch around noon and  
11 resume the hearing at one p.m. We will take short  
12 rest breaks in the morning and afternoon. We expect  
13 to end the hearing between five and six.

14 We have a court reporter who will prepare a  
15 transcript of the hearing. We expect to put a copy of  
16 the transcript in the docket for the rulemaking by  
17 next Thursday.

18 Also, for the sake of the court reporter,  
19 please state the spelling of your name when you come  
20 up to begin your presentation.

21 Everyone has the right to file reply  
22 comments which are due June 9. If anyone wants to  
23 challenge or support statements made at the hearing,  
24 they can do so in their reply comments, and we would  
25 encourage you to do so.

1           After the reply comments are filed, we will  
2 review them, the original comments, and the transcript  
3 for this hearing, and then decide what rules, if any,  
4 should be adopted. We intend to issue final rules as  
5 soon as reasonably possible.

6           I would also ask that cell phones, pagers  
7 with audible beepers be turned off to vibration mode  
8 or silent mode, please.

9           And I guess it's time to proceed, and the  
10 first representative will be from Sabre.

11           MR. SCHWARTE: Good morning, Mr. Chairman.  
12 My name is Dave Schwarte, that's S-C-H-W-A-R-T-E. I  
13 am executive vice president and general counsel of  
14 Sabre Holdings Corporation. I will be splitting my  
15 time this morning with Professor Steve Salop. We are  
16 cognizant of the 15-minute limitation rule and will  
17 adhere by it.

18           The Sabre travel network is the oldest,  
19 largest and most innovative provider of air  
20 transportation, information and booking capabilities  
21 in the world, and has served the travel industry for  
22 27 years.

23           At the outset allow me to express my thanks  
24 for holding this hearing and giving the opportunity to  
25 express my views.

1           My message today is simple.

2           First, the CRS rules have outlived their  
3 usefulness.

4           Second, the Department has no jurisdiction  
5 over independent systems like Sabre.

6           Third, the NPRM relies on erroneous  
7 assumptions about CRS market power, excessive booking  
8 feel, substitutability of alternative distribution  
9 channels and travel agent lock-in.

10           Fourth, the Department's NPRM is wrongly and  
11 deliberately unbalanced, and designed to give the  
12 airlines unneeded "bargaining leverage," at the  
13 expense of CRSs, travel agents, low-cost carriers, and  
14 consumers.

15           I'm going to cover each one of these points  
16 in detail.

17           Therefore, we strongly urge the Department  
18 to deregulate the industry as scheduled on January 31,  
19 2004. Regulation of this dynamic industry cannot hope  
20 to keep pace with changes in technology. Vigorous  
21 oversight by antitrust and consumer protection  
22 authorities is fully capable of disciplining any  
23 anticompetitive conduct.

24           Turning to my first point. The CRS rules  
25 are no longer necessary. We have charts on the



1 screen, and we have handed out charts to everyone in  
2 the audience as well. This is sort of the  
3 authoritative time line of what's happened in the CRS  
4 industry over the last 25 years.

5           As shown by that chart, in 1983,. CRSs  
6 processed 88 percent of all ticket transactions in the  
7 United States. By 2002 that number had declined to 53  
8 percent. In addition, the beginning, CRSs were owned  
9 by major airlines that used their control of CRSs to  
10 divert traffic to themselves and from other airlines.  
11 As you can see from the chart, major CRSs will soon  
12 be largely free of airline ownership.

13           It was conduct by airline owners of CRSs  
14 that prompted the Civil Aeronautics Board to adopt  
15 regulations in 1984. But the change in ownership has  
16 eliminated the need for those regulations. Two of the  
17 CRSs, Sabre and Galileo, are now independent of  
18 airline ownership completely. A third, WORLDSPAN, has  
19 said that it will be sold sometime this year, although  
20 we urge the Department to closely examine any  
21 continuing links between this CRS and its parent  
22 carriers.

23           An independent CRS, as Sabre, has no  
24 interest in diverting traffic to favor any airline.  
25 Our goal is to provide travel agents with the maximum

1 number of airline flights and fares.

2           As shown by our next chart, the Internet has  
3 gone from a novelty to a powerful tool for business  
4 and consumers. Eight-two percent of air passengers  
5 now use the Internet on a regular basis; half of all  
6 passengers use it to book. By year-end Internet  
7 sales will account for 30 percent of all airline  
8 ticket sales. While airlines set new web records  
9 every month, Sabre's bookings are now 16 percent in  
10 the first quarter of 2003 as compared with the first  
11 quarter of 2002.

12           So, given CRS bypass, airline divestiture,  
13 and the Internet explosion, there is no reason to  
14 continue the CRS rules.

15           MR. REYNOLDS: Mr. Schwarte, when you say 30  
16 percent of airline tickets will be sold on the  
17 Internet by the end of the year, is that by number or  
18 by revenue?

19           MR. SCHWARTE: It's by number.

20           MR. REYNOLDS: Okay.

21           MR. SCHWARTE: Thank you.

22           My second point is that the Department has  
23 no jurisdiction over independent CRSs like Sabre.  
24 Section 411 gives the Department authority over  
25 airlines and ticket agents. The Department

1 acknowledges that we're not an air carrier. It is  
2 equally clear that we are not a ticket agent. By  
3 statute, ticket agents are those who offer and sell  
4 tickets for air travel as principal or as agent of the  
5 airlines. Sabre is neither.

6 DoD acknowledges that we are not principals.  
7 Our contracts expressly provide that we are not  
8 agents, but independent contractors.

9 Sabre has never offered, sold or arranged to  
10 sell a single ticket to a passenger. We are not  
11 authorized by the airlines to do so. We have no  
12 public ticket offices and do not communicate with  
13 passengers.

14 At bottom, the Department's attempt to  
15 extend its jurisdiction to independent CRSs cannot be  
16 supported, and would not withstand judicial review,  
17 and cannot succeed with congressional action.

18 MR. REYNOLDS: Mr. Schwarte, so do you  
19 contend that there is no reasonable definition of the  
20 phrase "arranging for air transportation" that can be  
21 said to include the combined acts of presenting  
22 detailed edited information about air transportation  
23 services, and directly enabling the purchase of such  
24 services, that that cannot be construed as arranging  
25 for air transportation?

1           MR. SCHWARTE: Yes, we do, because we do not  
2 arrange it for the passenger themselves. We simply  
3 provide the data processing for the travel agent who  
4 does the arranging, and more fundamentally, we are not  
5 acting as an agent in any capacity for the airlines;  
6 instead, we act as an independent contractor.

7           Agent has a legal definition. We are not  
8 subject to the control and direction of the airlines;  
9 instead, we behave simply as independent contractors.

10          MR. REYNOLDS: What do you think that  
11 Congress is trying to capture using the word  
12 "arranging" in that definition then?

13          Because they seemed to lay out all the other  
14 things that describe perhaps a travel agency that  
15 people traditionally think of, and the airlines. What  
16 do you think they were trying to capture with  
17 "arranging"?

18          MR. SCHWARTE: I think what they were trying  
19 to capture is the individuals who interface directly  
20 with the public, who perform those tasks, and we do  
21 not.

22          My third point is that CRSs do not have  
23 market power. The NPRM relies on erroneous  
24 assumptions about CRS market power. CRSs engage in  
25 robust competition not only among themselves, but with

1 alternative distribution channels such as the Internet  
2 and airline sales. And Orbitz itself is a CRS waiting  
3 in the wings.

4           Since there is no market failure, the  
5 Department should not be regulating the details of  
6 Sabre's contracts with travel agents and airlines.  
7 Detailed command-and-control regulation has no place  
8 in an industry with vibrant competition.

9           The NPRM erroneously asserts that Sabre and  
10 other systems impose unreasonable contracts on  
11 airlines and set excessive prices. This just isn't  
12 so. In fact, Sabre has led the industry in crafting  
13 flexible contracts with airlines.

14           For example, 10 airlines, including US  
15 Airways and United, have accepted our innovative  
16 discount fee program. In exchange for providing us  
17 their full content and agreeing not to discriminate  
18 against Sabre agents, we provide discounts of 12  
19 percent off 2003 rates and freeze those rates for  
20 those airlines for three years. Such price  
21 concessions are the epitome of competition and refute  
22 any claim of CRS market power.

23           The issue of "excessive" booking fees is a  
24 red herring. booking fees represent a relative  
25 constant, roughly 2.5 percent, of total airline cost.

1           As you can see from the next chart, Sabre's  
2 booking fee increases have been moderate, especially  
3 when compared with booking fees charged by airline-  
4 owned WORLDSPAN. That chart plots the increases from  
5 1997 to the present. The green line for 2002 and 2003  
6 shows how the fees were reduced for those airlines who  
7 accepted the three-year program where we cut the fees  
8 by 10 percent off 2002 rates.

9           Also, Sabre's booking fee increases have  
10 grown slower than air transport Producer price Index.

11           The striking characteristic of the airlines'  
12 complaint in this docket about so-called exorbitant  
13 booking fees is that they have offered no proof to  
14 support that charge. In fact, booking fee increase  
15 have been driven by increased message volume, message  
16 complexity caused by increasing use of the Internet  
17 and increased look-to-book ratios as consumers surf on  
18 online travel agents for themselves.

19           MR. REYNOLDS: Mr. Schwarte.

20           MR. SCHWART: And by travel agency  
21 incentives.

22           Yes, Mr. Chairman.

23           MR. REYNOLDS: I'm sorry. In terms of -- do  
24 you have evidence or data indicating that booking fee  
25 costs have increased at the same or higher rates than

1 the booking fees themselves?

2 MR. SCHWARTE: As a matter of fact, in  
3 conjunction with our submission on March 17 we  
4 provided a cost study which showed that the increase  
5 in one item of cost alone had exceeded our fee  
6 increases.

7 Another obviously flawed assumption in the  
8 NPRM is the notion that travel agents are locked into  
9 CRS contracts. Nothing could be further from the  
10 truth.

11 Our comments and those of ASTA and the Large  
12 Agency Coalition debunked this myth. As shown by our  
13 last charge, today 53 percent of all CRS contracts are  
14 three years or less in length, and Sabre's contracts  
15 are even shorter. We don't have a graph for that.  
16 I'll give you the data.

17 Sixty-five percent of Sabre's contracts with  
18 travel agents are three years or less. Competition for  
19 agency business has driven them to a shorter term.

20 Finally, the CRS regulations are unfair and  
21 imbalanced.

22 MR. REYNOLDS: I'm sorry, just on that last  
23 point if I may.

24 MR. SCHWARTE: Yes, Mr. Chairman.

25 MR. REYNOLDS: You state, I think, in your

1 written comments though that WORLDSPAN and its owners  
2 get travel agents locked in in dominated hub cities.

3           What would stop that sort of thing from  
4 happening under normal commercial arrangements apart  
5 from the ownership tie?

6           MR. SCHWARTE: Mr. Chairman, I think you're  
7 referring to marketing agreements. And I think that  
8 you are, and I think the issue there is what exactly  
9 is in the marketing agreement.

10           We have made clear in our comments that if  
11 the Department were worried about marketing agreements  
12 we would not object to the Department banning the use  
13 of marketing agreements by airlines. As a matter  
14 fact, we advocated the adoption of the Canadian model  
15 where sales forces of airlines are precluded from  
16 marketing a system directly to travel agencies.

17           The rules are imbalanced. The NPRM was  
18 designed to enhance airline bargaining power by  
19 eliminating parent carrier obligations of mandatory  
20 participation, at the same time the NPRM proposes to  
21 micro manage our contracts with travel agents by  
22 limiting productivity payments, contract length, and  
23 compensation on termination.

24           To sum up, we urge that the CRSs be  
25 deregulated now. The CAB gave us three months to go



1 from an unregulated world to a regulated world in  
2 1984. If the Department will announce within a few  
3 months that the scheduled sunset date for January 31,  
4 2004 is firm, the market will prepare for deregulation  
5 with time to spare. Avoid the please of anyone who  
6 seeks some long or special transition provision. We  
7 are not afraid of the free market; nor should anyone  
8 else be.

9           Thank you for your time and I will turn over  
10 the remaining time that I have to Professor Salop.  
11 Thank you.

12           MR. SALOP: That's S-A-L-O-P. Thank you  
13 very much.

14           Last fall we actually had a natural  
15 experiment with respect to airline bargaining leverage  
16 vis-a-vis independent CRSs. As Dave Schwarte  
17 outlined, Sabre made a large price cut in exchange for  
18 getting all the web fares of the airlines.

19           Interestingly, web fares only account for  
20 about two percent of tickets. But the airlines had  
21 enough bargaining leverage that they were able to get  
22 Sabre and matched by Galileo to offer a very large  
23 price cut over three years to get access to them.

24           This was also a natural experiment for  
25 competition in that Galileo, the other independent

1 CRS, matched the offer.

2           At the same time note the difference between  
3 airline-owned CRSs. WORLDSPAN and Amadeus, the two  
4 airline-owned CRSs, did not match Sabre's offer, and  
5 the owners of WORLDSPAN did not take Sabre and  
6 government's offer. So that explains, it illustrates  
7 at least how airline ownership and ticket distribution  
8 can skew CRS competition.

9           More generally, I think that the NPRM  
10 erroneously assumes that consumers are locked into  
11 their usual travel agency, and that the travel  
12 agencies are locked into their current CRS. I think  
13 neither assumption is true. And you relax those  
14 assumptions you can see why the airlines have  
15 bargaining leverage over the CRSs.

16           Suppose an independent CRS were to delist a  
17 carrier. What would happen is many consumers  
18 immediately would switch from say those Sabre travel  
19 agencies to direct connect reservations. Other  
20 consumers would switch travel agencies. They would  
21 leave the Sabre travel agency. After all, why go to a  
22 travel agency that was missing flights from major  
23 airlines, and they would go to one that lists all the  
24 flights.

25           These switching consumers would not only

1 leave with respect to the Sabre -- excuse me -- with  
2 respect to the delisted carrier, but they would leave  
3 Sabre with respect to all their business.

4           In addition, it's not as if the travel  
5 agents would sit still for this. A lot of travel  
6 agents use multiple CRSs. They could immediately  
7 begin to use the other CRS instead of Sabre. In  
8 addition, as the contracts expire the travel agencies  
9 would switch, and other ones probably would switch  
10 even before the contracts expire rather than use a lot  
11 of business.

12           MR. REYNOLDS: Excuse me. How many travel  
13 agents have multiple systems and use them on an active  
14 basis? Do you have any sense of that?

15           MR. SALOP: More than 40 percent of Sabre.

16           MR. REYNOLDS: More than 40 percent, I'm  
17 sorry?

18           MR. SALOP: Of Sabre.

19           MR. REYNOLDS: Of Sabre customers have  
20 multiple systems?

21           MR. SALOP: Of Sabre's large -- more than 40  
22 percent of Sabre's bookings are made by travel agents  
23 that have multiple CRS connections, and there is a  
24 table in my report of March 17th to that effect.

25           MR. REYNOLDS: But you don't have a sense of

1 overall in the industry how many travel agencies that  
2 use CRSs have --

3 MR. SALOP: I only have data by volume of  
4 bookings.

5 MR. REYNOLDS: All right.

6 MR. SALOP: In addition, aside from the  
7 immediate lost bookings, and what I am explaining is  
8 why Sabre would lose more bookings and why the  
9 delisted carrier wouldn't lose as many, but this would  
10 also cause long-run harm to Sabre.

11 I mean, basically if Sabre were to delist a  
12 major carrier, its reputation with travel agencies  
13 would be destroyed.

14 So I think that this sort of analysis  
15 explains why CRSs like Sabre lacks bargaining leverage  
16 relative to the airlines, why the airlines have some  
17 bargaining leverage over the CRS.

18 In contrast, airline-owned CRSs and their  
19 owners have inherent incentives to disadvantage rival  
20 carriers and disadvantage rival CRSs. This gives them  
21 more bargaining leverage with airlines.

22 Thank you very much.

23 MR. REYNOLDS: Do smaller carriers have the  
24 same bargaining leverage as the larger carriers?

25 MR. SALOP: I think size is one of the

1 factors that affects bargaining leverage, but it's not  
2 the only one. For example, small carriers may be  
3 regionally very important. That would be one thing.  
4 Also, small carriers often have good alternatives to  
5 use carrier direct.

6 For example, lots of small carriers are  
7 localized and so they have an alternative way to reach  
8 customers through local advertising.

9 So I don't think size is the only factor.  
10 For example, Southwest is only on one CRS. It has a  
11 lot of bargaining power.

12 MR. REYNOLDS: Thank you.

13 MR. SALOP: Thank you.

14 MR. REYNOLDS: All right, thank you very  
15 much.

16 Next we have Amadeus.

17 MR. COBURN: Yes, thank you, Mr. Reynolds.  
18 My name is David Coburn, C-O-B-U-R-N. I am with the  
19 firm of Steptoe & Johnson here in Washington, and I am  
20 pleased and appreciate the Department's opportunity  
21 given me to speak on behalf of Amadeus With me is  
22 Phil Baxter, B-A-X-T-E-R, the vice president of  
23 Airline Business Group North America for Amadeus.

24 In the time I am allowed, I will cover five  
25 major points, which I will summarize now, and then go

1 back over each.

2 First, the rules have worked well since  
3 1984, in our view, to prevent bias and ensure fairness  
4 in CRS distribution practices.

5 While the industry is undoubtedly in  
6 transition in several respects, the Department could  
7 nonetheless reasonably conclude that the rules should  
8 be retained for a few more years while the existing  
9 competition in the distribution market continues to  
10 grow and mature.

11 Further, the Department can only abandon the  
12 rules, in our view, if it determines that doing so  
13 does not violate bilateral agreements that the United  
14 States has entered with other nations; a point we have  
15 spoken to in our initial comments, and I will speak to  
16 further in a few minutes.

17 Second, in view of developing technologies  
18 and new commercial arrangements, which were just  
19 described by Sabre, we are mindful that the Department  
20 might follow the path of deregulation. If it does so,  
21 our position that such deregulation should be complete  
22 deregulation as Sabre has advocated, because the  
23 partial deregulation that has been proposed will not  
24 yield a fully competitive environment and will hurt  
25 some parties and harm others.

1           Third, whichever approach the Department  
2 takes, it should treat all CRSs equally regardless of  
3 ownership. This is where we differ from Sabre. It  
4 has the legal authority, we believe, to do so under  
5 Section 411 as the NPRM indicates.

6           Given that CRSs provide a critical function  
7 in the offering and arranging for sale of air  
8 transportation, indeed we wouldn't be here today if  
9 CRSs were not central to the process of the sale of  
10 air transportation, and it would be an illogical  
11 result for the Department to conclude after so many  
12 years of CRS regulation that it suddenly has no  
13 jurisdiction over the major U.S. CRSs.

14           A bifurcation of jurisdiction over CRSs  
15 between the Department of Justice and FTC on the one  
16 hand, and DOT on the other is a strategy that is  
17 calculated to lead to uneven results and  
18 inconsistency, and confusion.

19           Further, to the extent that there are  
20 entities such as Orbitz or other online distributors  
21 that provide CRS-type services, they too should be  
22 regulated just like other CRSs. This is our even  
23 playing field argument.

24           Our fourth argument is that if the rules are  
25 retained some reforms are in order, and other reforms

1 are not. The rule against airlines tying their fares  
2 and benefits to use of an affiliated system, whether  
3 affiliated by ownership or affiliated by marketing  
4 arrangement, is a rule that should be strengthened and  
5 enforced by the Department, and our comments speak to  
6 that extensively.

7           The mandatory participation rule, if rules  
8 are retained, should be expanded to cover marketing  
9 carriers. Subscriber contract terms should be  
10 shortened as per the EU rule, and liquidated damages  
11 for contract cancellation should not be based on lost  
12 booking fees. The proposed MIDT reforms on the other  
13 hand should not be adopted.

14           Fifth, and finally, any significant  
15 modification of the rules should provide for an  
16 appropriate transition period given that contracts and  
17 arrangements and relationships between parties would  
18 need to be reordered in a deregulated environment or  
19 an environment where significant changes are made to  
20 the rule, such as the changes proposed in the NPRM.

21           We think an appropriate transition period is  
22 something on the order of at least 18 months.

23           Turning to the first point, there is no  
24 question that competition in the distribution sector  
25 already strong is transitioning to a point where



1 alternatives to CRS-based distribution are gaining  
2 even further prominence. Internet options, direct  
3 connect technology, new commercial arrangements  
4 between industry players are changing the dynamics of  
5 the marketplace. Notably the rules have not been an  
6 impediment to these changes which are occurring even  
7 in a regulated setting.

8           The rules have been effective, we believe,  
9 over the years in eliminating distortions that could  
10 result from bias displays and discriminatory fees and  
11 services. The rules have thus promoted airline  
12 competition and consumer welfare.

13           As to booking fees, which you will hear a  
14 great amount today I'm certain, we agree with Sabre  
15 that they have not risen unreasonable, and in fact in  
16 recent years in the case of Amadeus they have risen  
17 very modestly, and in some cases not at all, and we'll  
18 go into some detail on that in our reply comments.

19           The fees are tempered by --

20           MR. REYNOLDS: If I may interrupt just a  
21 second.

22           MR. COBURN: Certainly.

23           MR. REYNOLDS: And I apologize for  
24 interrupting --

25           MR. COBURN: No problem.

1           MR. REYNOLDS: -- in the middle of your  
2 point there. But throughout the airline industry  
3 major suppliers seem to be making pretty significant  
4 concessions to the airlines. How is it that the CRSs  
5 are not one of those suppliers?

6           I mean, they seem to be maintaining pretty  
7 significant levels in terms of their --

8           MR. COBURN: I can't speak to other CRSs. I  
9 can speak to Amadeus. Major concessions have been  
10 made. Amadeus since September 11, 2001, has offered a  
11 discount program, and we will describe that in our  
12 reply comments, to carriers. So significant  
13 concessions have been made, and indeed between 2002  
14 and 2003 on some types of participation fees have not  
15 gone up at all. To the extent they have gone up the  
16 increases have been very modest, and designed to  
17 reflect increased costs, and I'll get to some of the  
18 factors that contribute to those costs in a minute.

19           Fees are tempered by the competitive options  
20 that are available to airlines. We will address that  
21 point in our reply comments as well.

22           And as I mentioned, the cost of labor and  
23 the cost of technology and technology burdens on  
24 systems have to be taken into account when you're  
25 discussing fees.

1           For example, in the first three months of  
2 2001, or between the first three months of 2001 and  
3 the first three months of 2002, the average number  
4 increase to the Amadeus system per booking increased  
5 from 45 to somewhere between 75 and 85.

6           In February 2003, which is the most recent  
7 data I have, it increased to 96 inquiries per booking.

8   Now what that means is that increased burden is  
9 placed on the system to account for all of these  
10 increased inquiries, many of which are prompted by the  
11 growth in Internet technology.

12           That results in increased burden on the  
13 infrastructure, which in turn, of course, leads to  
14 more investments that the CRSs have to make.

15           Further, airlines have been pushed by the  
16 airline community, and I'm not being critical here,  
17 but it's a reality, to provide new functions. E-  
18 ticketing, interline e-ticketing, these are expensive  
19 functionalities to provide. You don't just snap your  
20 fingers and there they are. You have to invest in  
21 technology. Those investments, of course, have a cost  
22 consequence and a booking fee consequence.

23           Fees also remain, as was stated earlier, a  
24 small fraction of total airline costs, about 2.5  
25 percent, and that figure has to be viewed in relation

1 to the revenues that are generated for airlines as a  
2 result of what the CRSs do. What they do, of course,  
3 is generate the passengers that fill the airplanes.

4           While airline ownership of CRSs has  
5 diminished in the U.S., the prospect of major airlines  
6 influencing CRSs through marketing arrangements has  
7 not, and this is an important point that I think goes  
8 to the question of the impact of ownership, airline  
9 ownership of CRSs.

10           Ownership or lack thereof should not be  
11 viewed as a decisive factor on the question of  
12 regulation because in our view the more important  
13 inquiry is whether the rules provide a safeguard  
14 against the potential that systems might enter  
15 arrangements with airlines that could be detrimental  
16 to other airlines or consumers, and that potential  
17 exists by virtue of marketing relationships and other  
18 commercial arrangements that may exist.

19           To date, the rules have provided the  
20 safeguard against the abuses that can exist as a  
21 result of such arrangements.

22           The views of the commenters here in the  
23 audience and others certainly differ widely on whether  
24 the rules continue to serve a useful function.  
25 Smaller airlines and travel agency interests generally

1 want the rules to continue for some period of time.  
2 Some major U.S. airlines do not, or they want only  
3 portions of the rules to continue for some period of  
4 time. The online distributors and CRSs are split on  
5 the issue.

6           The very diversity of views illustrates that  
7 there is no clear or right answer. It also underscore  
8 that the Department should be cautious to ensure that  
9 its actions do not result in precisely the distortions  
10 that the rules are designed to avoid.

11           Yes?

12           MR. REYNOLDS: If I may pose a question  
13 here. Why hasn't Amadeus, unlike Galileo and Sabre,  
14 offered airlines a discount on their booking fees in  
15 exchange for access to their web fares?

16           MR. COBURN: Well, it's a commercial  
17 decision and I am not at liberty to speak to why  
18 Amadeus has chosen one path or another. It has  
19 nothing to do with the fact that we are airline-owned.  
20 The airlines that own, own a portion of Amadeus,  
21 because Amadeus is also substantially owned by the  
22 public, don't control those decisions.

23           Whether Amadeus at some point chooses to  
24 match the offers of the other airlines which have not  
25 attracted, we note a large number of airlines to those

1 offers, or not is a commercial decision that I am sure  
2 is being considered.

3           Were the Department to eliminate the rules  
4 or propose to eliminate the rules, we believe it could  
5 only do so to the extent doing so is consistent with  
6 the obligations of the United States under its  
7 bilateral agreements, which I'll note that few parties  
8 have spoken to, so I will be in the minority here  
9 perhaps.

10           Many of those agreements contain detailed  
11 CRS provisions that in recent years the United States  
12 has negotiated. These aren't old fixtures of the  
13 bilateral structure. These are relatively recent  
14 development.

15           The United States has assumed the obligation  
16 in these agreements to provide, among other points,  
17 that, number one, information on international air  
18 services and connections will be displayed objectively  
19 and in a nondiscriminatory way; two, that all CRSs  
20 shall be obligated to operate in conformity with  
21 applicable rules; three, that all airlines willing to  
22 pay a nondiscriminatory fee must be assured the right  
23 to participate in the CRSs operating in each nation's  
24 territory; and four, that all distribution facilities  
25 that the CRSs provides shall be offered on an

1 nondiscriminatory basis to participating airlines.

2           Those are the words which I have  
3 paraphrased, but those are essentially the words of  
4 the bilaterals, and only some of the points.

5           Now, the rules are obviously an efficient  
6 way to ensure consistency with these obligations as  
7 the Department has found in the past in it's 1992  
8 rulemaking. Reliance on Section 411 actions, case-by-  
9 case actions, to do so could yield inconsistent  
10 results and impose undue burdens on the Department.

11           Also, some bilateral infractions may not  
12 rise to the level of a Section 411 violation.  
13 Deregulation, in short, can only be accomplished to  
14 the extent the Department deals with these issues, and  
15 we're not saying the bilaterals are immutable. We are  
16 just saying you have to deal with them and you have to  
17 find a way perhaps of renegotiating the bilaterals  
18 before you can take a step as radical as deregulation.

19           Our second point is that partial  
20 deregulation should be avoided. Keeping the rules in  
21 place in terms of service discrimination while  
22 allowing negotiation on booking fees will do one  
23 thing, and that is favor the large carriers with the  
24 largest volume of transactions while hurting smaller  
25 volume foreign carriers, and smaller U.S. carriers.

1 And to the extent you hurt smaller volume foreign  
2 carriers, that, it appears to us and according to some  
3 of the foreign carrier commenters, would be contrary  
4 to bilateral obligations.

5           The predicate for allowing booking fee  
6 negotiations is that airlines can bargain on an equal  
7 footing with CRSs. If that's true, then, and we  
8 believe the Department could find its true, the  
9 parties should be allowed to bargain over matters such  
10 as the provision of enhancements, screen placement,  
11 loading of information, and parity clauses; in other  
12 words, that we should be able to bargain on an equal  
13 footing on all of those matters.

14           MR. REYNOLDS: Before your time ends, in  
15 terms of bargaining, especially if the rules are not  
16 in existence, do you believe that bias is something  
17 that should be bargained for?

18           MR. COBURN: Well, it's bargained for today  
19 in the online sector. It's bargained for -- Orbitz  
20 can bargain for bias today. Whether it does or not is  
21 a different issue, but it certainly can. There is  
22 nothing to prevent it from doing so, and yet it is  
23 acting like a CRS under its arrangement with Aqua, and  
24 recent reports suggest that it's actively doing that.  
25 They -- I'm sorry.



1           MR. REYNOLDS: Does Amadeus sell bias in  
2 non-airline industries for which it provides --

3           MR. COBURN: I'm not aware that it does, but  
4 I would have to double check that answer.

5           Our point here is that the partial  
6 deregulation will not fulfill the goal of a fully  
7 competitive environment, and likewise, the partial  
8 deregulation that several major U.S. carriers and  
9 Orbitz are propounding should be rejected for the same  
10 reason. It will benefit those parties. It will not  
11 benefit competition as a whole. It will not benefit  
12 consumers. So therefore if you deregulate, deregulate  
13 fully.

14           Our third point is that any decision made by  
15 DOT on the future of the rules must apply across the  
16 board to all systems. We will deal extensively with  
17 this in our reply comments. I know I am short of  
18 time. I am not going to go into great deal, but  
19 suffice it to say, as I did a minute ago, that we  
20 wouldn't be here if what we did was not central to the  
21 arranging of air transportation, and to suggest it's  
22 not just doesn't make sense to us.

23           On top of which, to the extent you find that  
24 some CRSs are not subject to deregulation and others  
25 are, that's not a tenable result that we think the

1 Department. If you can bear with me just a few more  
2 seconds.

3 MR. REYNOLDS: I'm going to have to be a  
4 little cruel --

5 MR. COBURN: Okay.

6 MR. REYNOLDS: -- on this point. We have  
7 got a lot of ground to cover, and it's a long day.

8 MR. COBURN: No problem.

9 MR. REYNOLDS: So I apologize for that. But  
10 thank you very much for your remarks.

11 MR. COBURN: Thank you.

12 MR. REYNOLDS: Next we have WORLDSPAN.

13 MR. SIMPSON: Good morning, Mr. Reynolds,  
14 members of the panel. My name is Charles Simpson,  
15 S-I-M-P-S-O-N. I'm a partner in the law firm of  
16 Zuckert, Scoutt & Rasenberger, and I am appearing  
17 today on behalf of WORLDSPAN.

18 I am joined today by Doug Abramson, who is  
19 the senior vice president and general counsel of  
20 WORLDSPAN, and Jessie Liebman, who is the senior vice  
21 president of strategic planning.

22 WORLDSPAN's position is straightforward.  
23 There is neither sufficient evidence nor a policy  
24 basis to warrant the continued imposition of special  
25 rules that constrain the operations and commercial

1 freedom of CRSs, especially when the rules are applied  
2 on a disparate basis to various competitors in the  
3 distribution market.

4           The Department should terminate Part 255 on  
5 the current sunset date, or alternatively, within 12  
6 months after that date, put all parties on an equal  
7 unregulated footing, and allow market forces to  
8 govern, just as they do in virtually every other  
9 industry.

10           The key question in this proceeding is the  
11 following: If the Department were examining a CRS  
12 market and its relations with airlines for the first  
13 time in 2003, would it conclude that there is a  
14 proven, compelling need to protect competition between  
15 airlines by imposing a comprehensive body of  
16 regulations on CRSs?

17           WORLDSPAN submits the answer clearly is no.

18           The operative presumption in this proceeding  
19 and under this administration must be that market  
20 forces can and will discipline the conduct of market  
21 participants. If market forces fail, harmful conduct  
22 can be dealt with on a case-by-case basis.

23           Sweeping government intervention into such  
24 as rules proposed into the market in order to protect  
25 competition should be a last resort, and should be

1 undertaken only in extreme situations that are marked  
2 by proven ongoing patterns of broad systematic abuse,  
3 and that situation simply does not exist today.

4           Part 255 was promulgated in 1984 primarily  
5 to address the pervasive conduct of the two largest  
6 airlines in the United States who were using their  
7 wholly owned, wholly integrated systems to distort  
8 competition with other airlines.

9           There has obviously been a great deal of  
10 change since then. There is no longer a basis for  
11 treating CRSs as integrated appendages of airlines  
12 because they aren't. Airline ownership or control of  
13 CRSs is almost gone. As you know, Sabre and Galileo  
14 have fully divested their airline ownership. WORLDSPAN  
15 is on the verge of being fully divested by its three  
16 owner airline owners.

17           Airline use of CRSs as competitive weapons  
18 has ended. There is no longer any nexus between CRSs  
19 and competition distorting conduct by airlines. As  
20 others have discussed, and many people have said in  
21 their comments, the Internet has provided significant  
22 alternatives to CRSs, market innovations by airlines  
23 and others that have facilitated the bypassing of CRSs  
24 and the traditional CRS travel agency model, which was  
25 at the heart of the rules in the first place.

1           So in short, the set of circumstances that  
2 warranted the creation of Part 255 no longer exists.

3           MR. REYNOLDS: If I may interrupt.

4           MR. SIMPSON: Yes, sir.

5           MR. REYNOLDS: Without the rules, what is to  
6 stop the major airlines from becoming closely  
7 affiliated with the CRSs, and using them to exert  
8 market power over smaller carries, especially in  
9 dominated hub cities where the CRS may also have a  
10 dominant position among travel agencies as well?

11           I mean, in other words, is there no  
12 reasonable possibility that airlines and CRSs won't  
13 work together on commercial terms in ways that mirror  
14 the anticompetitive behavior that occurred when there  
15 were ownership ties that generated the rules in the  
16 first place?

17           MR. SIMPSON: Well, you have raised a very  
18 hypothetical, very speculative possibility, in our  
19 view. First of all, you know, we take the position as  
20 Sabre and Galileo, that CRSs do not hold market power.  
21 To the extent airlines hold market power, you would  
22 have to ask the question of them. We do not believe  
23 they do.

24           MR. REYNOLDS: But wasn't it --

25           MR. SIMPSON: Just let me finish.

1 MR. REYNOLDS: Sure. I'm sorry.

2 MR. SIMPSON: I think the key, you have  
3 touched on the key consideration. There is no  
4 evidence that this is going to occur. Your actions in  
5 this proceeding have to be based on substantial  
6 evidence. There is no record. This is not 1984.  
7 There is no evidence that airlines are doing exactly  
8 what you said, and whereas airlines and CRSs were much  
9 closely affiliated, they no longer are.

10 And so in 2003, as I was saying, there is no  
11 proven need for the Department to continue to protect  
12 airlines by, for example, dictating the CRSs, the  
13 terms of the agreements that airlines and CRSs enter  
14 into, and I think this is particularly true because  
15 the Department has correctly proposed to eliminate the  
16 fee discrimination rule and the mandatory  
17 participation rule, which should free up both sides to  
18 negotiate new and innovative commercial relationships.

19 In our view, there is also no proven need  
20 for the Department to dictate the terms of agreements  
21 between travel agencies and CRSs. The airline  
22 competition, in our view, is not being distorted by  
23 subscriber contract provisions. The agencies don't  
24 need this form of government protection.

25 In fact, to the contrary, and here we do

1 have a record, the record reflects intense competition  
2 among CRSs for the travel agencies' business.

3           So to repeat what I said a second ago in  
4 response to your question, at the end of the day  
5 absent substantial proof on the record that airlines  
6 are currently using, and successfully using CRSs as  
7 weapons against one another on a systematic basis to  
8 gain unfair advantages against other airlines, there  
9 is no valid basis for continuing to regulate CRSs.

10           In the initial comments filed in March  
11 reveal, in our view, a substantial consensus for  
12 terminating Part 255 over a fairly near term. This  
13 consensus includes many of the airlines, the  
14 competition between which was -- Part 255 was intended  
15 to protect in the first place.

16           In our view, the main issue before the  
17 Department then is not whether Part 255 should  
18 terminate, but how soon Part 255 should terminate.

19           WORLDSPAN and others have said that the  
20 rules should terminate as soon as possible, such as on  
21 the sunset date. Several other parties have proposed  
22 the immediate elimination of most of the rules, but  
23 not all of the rules, followed by a three-year  
24 transition to full deregulation.

25           As an alternative, WORLDSPAN has suggested

1 that the Department eliminate the rules that it has  
2 proposed to eliminate, add no new rules, not expand  
3 any existing rules, and then follow that by a one-year  
4 transition to full deregulation.

5 WORLDSPAN believes that 12 months is a  
6 sufficient period to ease into deregulation without  
7 any significant market disruptions, and we think three  
8 years is too much.

9 MR. REYNOLDS: Just if I may, what evidence  
10 is there that systems actually compete for airline  
11 participants? I mean, is that belied by the fact that  
12 Sabre alone accounts for one-third of all airline  
13 revenue?

14 MR. SIMPSON: I'm not familiar with the  
15 data, that particular piece of data, but the  
16 competitive environment is -- you know, is changing as  
17 rapidly as any environment of any competitive industry  
18 in the country, and alternatives to CRS are increasing  
19 as the record clearly reflects. And to the extent  
20 airlines have an alternative to CRSs, as they do, as  
21 they increasingly do, their ability to negotiate CRSs  
22 increases accordingly. I think that answers your  
23 question. I'm not sure.

24 MR. REYNOLDS: Okay. Continue, please.

25 MR. SIMPSON: As to the subject of



1 transition, WORLDSPAN submits that any transition to  
2 deregulation must not include any new rules as some  
3 airlines and some others have proposed. In our view,  
4 this idea is imponderless [sic] on its face. The  
5 purpose of the transition period is to smooth the way  
6 to a new environment, not to make it more cumbersome.  
7 The addition of new regulatory burdens to which the  
8 parties and the market would have to adjust, followed  
9 by a soon thereafter by a readjustment when the rules  
10 terminate makes no sense at all to us, and will create  
11 unnecessary expenses and inefficiencies.

12           At bottom, all CRSs and other distribution  
13 channels should be put in the same fair and even-  
14 handed regulatory footing. Full deregulation is the  
15 surest and best means of doing so.

16           As among the four CRSs, there is no basis in  
17 the record, in policy, or in common sense to regulate  
18 some of the existing CRSs but not others. They should  
19 all be deregulated.

20           Our friends at Sabre, of course, have  
21 suggested that Sabre and Galileo should be immediately  
22 deregulated, but that WORLDSPAN should continue to be  
23 regulated as long as it has any airline ownership or  
24 control. In Sabre's view the alleged "vertical  
25 integration" of WORLDSPAN could in theory be a threat

1 to airline competition.

2 Sabre's position ignores the facts and the  
3 reality. Sabre and Galileo themselves represent over  
4 70 percent of the traditional CRS market. If there  
5 were ever a market power issue requiring the  
6 government's attention, and we are not saying there  
7 is, but if there ever were one logical indicates that  
8 the issue would more likely lie with the two largest  
9 companies, Sabre and Galileo.

10 Furthermore, the smaller WORLDSPAN is owned  
11 by three airlines that compete very fiercely with each  
12 other. None of them owns a majority interest in  
13 WORLDSPAN. None of them use WORLDSPAN as a  
14 competitive weapon. One of them, American Airlines,  
15 the largest airline in the world. has an exclusive  
16 marketing relationship with Sabre, not with WORLDSPAN.

17 Unlike Sabre and Galileo, harking back to  
18 1984, which were once wholly owned, wholly integrated,  
19 exclusive marketing tools with the airline owners,  
20 WORLDSPAN is not integrated into any airline.  
21 WORLDSPAN and its owners don't even take the same  
22 position in this proceeding.

23 In any event, WORLDSPAN is on track to be  
24 sold to non-airline investors this summer, after which  
25 no airline will hold any equity interest in WORLDSPAN.

1 No airline will be represented on the board of  
2 directors of WORLDSPAN. No airline will control  
3 WORLDSPAN in any way. WORLDSPAN will continue to have  
4 marketing relationships which are really more in the  
5 nature of promotional relationships with Northwest and  
6 Delta, just as it does today, and just as we believe  
7 Sabre has with American, Sabre has with Southwest,  
8 Galileo has with United. Nothing unusual about that.

9 MR. REYNOLDS: Mr. Simpson, do you contend  
10 that DoD does not have authority to regulate CRSs that  
11 are marketing by airlines?

12 MR. SIMPSON: We have -- we have observed  
13 the Department's proposition that CRSs are ticket  
14 agents, and we think that's a novel and possibly  
15 ambitious interpretation of that phrase. And we have  
16 not fully engaged the issue deliberately, but we do  
17 believe that whether that interpretation is valid or  
18 not is a question that the courts will ultimately  
19 answer.

20 MR. REYNOLDS: I'm sorry. I want to just  
21 sort of go back and touch on another point on market  
22 power.

23 Why would the Internet eliminate these  
24 systems market power if a large number of travelers  
25 prefer to use travel agents, and travel agents rely on

1 a system to research and book airline services?

2 MR. SIMPSON: I guess I can't accept the  
3 premise, which is that CRSs have market power, so  
4 where do we go from there?

5 MR. REYNOLDS: So that CRSs never have  
6 market power?

7 MR. SIMPSON: Never had that -- no, that's  
8 not my statement.

9 MR. REYNOLDS: Oh.

10 MR. SIMPSON: My statement is today in the  
11 environment that you were proposing either to or not  
12 to regulate CRSs do not have market power.

13 MR. REYNOLDS: But don't you -- I mean, they  
14 never -- I mean, do you contend that they never had  
15 it?

16 MR. SIMPSON: I think we are -- I think we  
17 get into a semantic difficulty, which is -- I'm  
18 serious -- do CRSs have market power, or do they have  
19 bargaining power, and I think it's fair to say CRSs  
20 have bargaining power vis-a-vis airlines. Whether  
21 that arises to market power in an antitrust  
22 definition, I would disagree.

23 MR. REYNOLDS: Well --

24 MR. SIMPSON: And if I may.

25 MR. REYNOLDS: Sure.

1           MR. SIMPSON: I participated in litigation  
2 that actually alleged that CRSs were essential  
3 facilities under Section 2 of the Sherman Act, and we  
4 were proven wrong by the Ninth Circuit. So no,  
5 certainly on definitive body has determined that CRSs  
6 hold market power vis-a-vis airlines or anybody else.

7           MR. REYNOLDS: Okay. I would just note,  
8 didn't, in 1991, DOJ find that CRSs exercise market  
9 power with respect to booking fees?

10          MR. SIMPSON: And I contend that we're  
11 talking about a semantic difference, and what DOJ was  
12 really referring to was the bargaining advantage, and  
13 I submit that that advantage is significantly reduced  
14 since 1991.

15          MR. REYNOLDS: Please.

16          MR. SIMPSON: Back to Sabre, because they  
17 spent so much time on WORLDSPAN, let me just say as an  
18 aside if the Department is inclined to engage in the  
19 sort of narrowly selective regulation that Sabre  
20 espouses, perhaps, and this is just an idea, perhaps  
21 the Department should consider issuing a rule that  
22 prohibits any air carrier from participating in a CRS  
23 that has more than a certain percentage of the  
24 traditional CRS market, say 35 or 40 percent, unless  
25 that CRS complies with certain standards established

1 by the Department for CRS conduct.

2           In any event, considering that Sabre and  
3 WORLDSPAN both favor a full and prompt deregulation,  
4 the discussion of Sabre and WORLDSPAN is really sort  
5 of an unnecessary side show, in my view. What is far  
6 more worthy of comment is the Department's unwarranted  
7 proposal to continue to regulate CRSs as a whole while  
8 other distribution channels, such as online travel  
9 agencies, go unregulated.

10           The record shows that other channels compete  
11 directly with CRSs for airline, consumer, corporate  
12 and travel agency business, and are establishing an  
13 increasing share of the market. The record does not  
14 establish a valid reason for continuing to regulate  
15 one selected body of competitors while not doing so  
16 for the others, and we submit that none of them should  
17 be regulated. We are not advocating regulating  
18 anybody. We are advocating deregulating everybody.

19           So you have to ask how is the public  
20 interest served by forcing WORLDSPAN or any other CRS  
21 to compete with other distribution channels with one  
22 arm tied behind its back? And how does it make sense  
23 to regulate CRSs that provide information to  
24 professional travel agencies and not regulate Web  
25 sites that provide information directly to end consumers?

1           The best answer to both questions is to free  
2 CRSs from regulation and enable vigorous competition  
3 among all the parties in the market.

4           Thank you very much.

5           MR. REYNOLDS: Thank you very much.

6           Next we have Technet Texas, and I believe  
7 they are splitting their time with Hewlett Packard.

8           MR. WHITE: Thank you very much. I am Rick  
9 White. I am actually the CEO of Technet nationwide.  
10 We do have a Texas office, but it's Technet in its  
11 international capacity is here today, and we are  
12 splitting our time with Hewlett Packard. Michelle  
13 Blair will be represent them for seven and a half  
14 minutes, so I will try to be very brief.

15           Technet is an organization of about 200  
16 technology companies. It's a CU-based organization.  
17 We represent technology companies around the country  
18 with offices in Texas, California, Washington State  
19 and New England, Boston. Many of our companies are  
20 the people who create the Internet, who run the  
21 Internet today, who have spent a lot of time working  
22 on the Internet. We also have a lot of members who  
23 travel a lot, use online travel services, and really  
24 those are the two reasons that we wanted to come and  
25 talk to you today in this proceeding.

1           We are the technology community in general.

2   We are big believers in a free marketplace. We know  
3 this administration is a big believer in the free  
4 marketplace.

5           We have been cooperating with the  
6 administration recently on a public/private approach  
7 to cyber security. We have been working on some FCC  
8 regulations that are going in a direction of  
9 deregulation. We are very much in favor of that just  
10 in general. We know you are too.

11           And we have the sense that this proposal  
12 that you have that we're discussing today kind of goes  
13 in the wrong direction, and that's why we felt it was  
14 important to comment.

15           We think that the travel industry, the  
16 online travel industry is really one of the greatest  
17 success stories of technology in the Internet. It has  
18 been great for consumers. It has gotten all kinds of  
19 information out there. We think it's great for the  
20 industry too, and in the long run it's going to make a  
21 great positive contribution to the way the industry  
22 operates.

23           We think it's doing very well on its own.  
24 We would hate to see it suffer from distorting rules  
25 and regulations adopted for all the right reasons that



1 would nevertheless channel these energies in a way  
2 that may be less appropriate.

3           So we would basically say two things in  
4 terms of considering what the Department is up to  
5 today.

6           First, we think in an effort to protect the  
7 travel industry and the online part of that industry  
8 your rules are actually having the opposite effect.  
9 We are afraid that these proposed rules would hamper  
10 the back bone of electronic travel, commerce and  
11 distribution, hamper the global distribution systems  
12 that provide information to consumers, and we think it  
13 would be a mistake to be choosing different players in  
14 the marketplace and treating them different.

15           You know, in the travel industry, and every  
16 place in the technology industry, especially in e-  
17 commerce, the system works best if there is free,  
18 unrestricted flow of information. Everybody has  
19 access to the same information. That's what really  
20 gets the marketplace working, and we're afraid that  
21 the rules you are proposing today would seem to move  
22 in the wrong direction.

23           The other reason that we are concerned is  
24 really just as consumers of these services we hate to  
25 see the marketplace distorted in a way that would

1 restrict the information that we get from all sources  
2 where we have to go to different sources to get  
3 information that ought to be freely available to all.

4           We feel we have now access to comprehensive  
5 choices, flight and fare options that are driven by  
6 competitive forces in the marketplace, and by  
7 regulating who can do what and who has access to what  
8 information, we are concerned that that will have a  
9 negative impact on those choices.

10           So the better approach, we think, and I  
11 think a lot of people have said that today, but I  
12 suspect there are people who will also take a  
13 different point of view, will be just to have complete  
14 and total deregulation right off the bat. We know  
15 that sometimes it is a difficult step to take,  
16 especially in an industry that has been regulated for  
17 a long period of time.

18           It creates a little uncertainty in the  
19 marketplace. You might need to have a little bit of a  
20 transition period we understand. But in the long run  
21 a little creative marketplace turmoil will be a  
22 positive thing. People the marketplace should expect  
23 to have to compete with each other and to make  
24 changes. They should welcome that, and over the long  
25 run we think it will have a positive impact on the

1 industry.

2           So just in summary, at TechNet we think it  
3 would be a mistake to have the Department of  
4 Transportation get too heavily involved in deciding  
5 how CRS markets should operate. We think it would be  
6 better to let the free marketplace work, especially in  
7 areas where technology is driving what's going on.

8           It's hard for the government to keep up with  
9 what technology is doing in the marketplace, not  
10 necessarily a good idea to try. What you want to do  
11 is set some rules and let people, you know,  
12 participate in the marketplace and let technology do  
13 what it will.

14           So we would encourage you to move toward  
15 immediate and total deregulation. We think it would  
16 make the marketplace better. It will allow the  
17 technology to flourish, and it would actually provide  
18 better services to our members which they take very  
19 seriously and have enjoyed using so far.

20           So those are our comments. Thank you very  
21 much.

22           MR. REYNOLDS: Thank you.

23           MS. BLAIR: Good morning. My name is  
24 Michelle Blair, and I am a manager of government  
25 affairs for the Hewlett Packard Company.

1           As a founding member of TechNet, and as one  
2 of the largest stakeholders in your decisions  
3 concerning the future regulation of airline ticket  
4 distribution, we greatly appreciate the opportunity to  
5 testify today concerning the Department's notice of  
6 proposed rulemaking regarding Computer Reservation  
7 Systems and Statement of General Policy.

8           Unlike many of the other witnesses today, we  
9 have not participated to date in the Department's many  
10 rulemakings over the last several years.

11           HP is extensively involved in the travel  
12 business both as a customer or a customer who spent  
13 over \$280 million in travel last year, and as a  
14 leading technology provider, creating the next  
15 generation travel technology platform through our  
16 nonstop Himila server and database environment. It is  
17 in HP's role as a leading technology provider that I  
18 come before you today.

19           In general, HP believes that technology and  
20 innovation work worst when the government attempts to  
21 pick winners and losers and issues detailed command  
22 and control regulation. From our vantage point, the  
23 Department's proposed CRS rules and policy statement  
24 do just that.

25           With our help the Computer Reservation

1 System industry is in the middle of a radical  
2 transformation. The Department was unquestionably  
3 right when it noted in its rulemaking that the  
4 Internet has largely transformed customer access to  
5 flight schedule and fare information.

6           What it did not note was the profound nature  
7 of the changes in the data management and offering  
8 from the Global Distribution System, or GDSs. The  
9 Internet has caused a huge explosion in the look-to-  
10 book ratio as more and more consumers access the  
11 Internet, gain confidence to conduct a transaction,  
12 and then shop from one site to another. HP is proud  
13 to be a part of this transformation.

14           As we speak, we are helping to build a  
15 server network for the airline industry that  
16 continuously updates about 20 million fares and 1.5  
17 million schedules to provide travelers and travel  
18 agents with real time data. We are helping to process  
19 14,000 messages per second in an average peak hour.

20           We are designing a system that will provide  
21 unparalleled availability and scalability, coupled  
22 with significantly lower total cost of ownership. Our  
23 linear scalability, we have more than 4,000  
24 processors and over 16 TARA bytes of memory with open  
25 systems technology so we can bring best of breed

1 options on line extraordinarily fast.

2           If the Department thinks the pace of change  
3 in air travel distribution has been fast in the past  
4 decade, just wait for the next few years. HP is  
5 already through phases I and II of an exciting project  
6 begun in 2001 with the GDS leader, Sabre, to build the  
7 next generation GDS. Working together, we are well on  
8 our way to quantum leaps and productivity, integrity,  
9 speed, and capability from continuously available  
10 architecture that will bring both in-house and third  
11 party software advances to the market in record time.

12           Real time integration of GDS data into  
13 relational databases will, with the cooperation of the  
14 airlines, allow systems to build in-business logic to  
15 reservation systems.

16           For example, the technology will enable the  
17 system to automatically release seats at a lower price  
18 if the airline hasn't sold enough by a preset date.

19           These systems will provide immeasurable  
20 benefits to travel agents, airlines, GDSs and the  
21 traveling public who will have instant access within  
22 three second to the widest variety of options at the  
23 best possible price.

24           HP is helping the leading GDS move from  
25 mainframes using older transaction processing

1 facilities to open system that use relational  
2 databases in Uninx and Windows NT operating systems.

3 We are developing this new open architecture through  
4 our nonstop Himila technology, and the result so far  
5 are quite promising with outstanding 24/7 reliability,  
6 so stay tuned.

7           From HP's view, however, the one thing that  
8 could prevent further innovation is the heavy-hand of  
9 government. For this reason, we respectfully urge the  
10 Department to revisit its approach to this CRS rules,  
11 withdraw the proposed rule and policy statement in  
12 their entirety, and instead allow market forces, not  
13 regulation, to work for consumers.

14           Thank you again for the opportunity to  
15 appear before you today, and I would be happy to take  
16 any questions.

17           MR. REYNOLDS: Maybe just one question.

18           MS. BLAIR: Okay.

19           MR. REYNOLDS: How much of HP's travel is  
20 booked through travel agencies and how much is booked  
21 through the Internet?

22           MS. BLAIR: We actually have a travel agency  
23 that we use, and it is -- they use online. We  
24 actually don't use Sabre. We use another company, but  
25 we do use the GDS.

1 MR. REYNOLDS: Thank you.

2 Next, we have Galileo.

3 MS. CUPP: Good morning. I am Cathy Cupp,  
4 and that's C-A-T-H-Y, C-U-P-P. I'm the senior vice  
5 president and general counsel of Galileo  
6 International. Thank you for the opportunity to speak  
7 today.

8 In the long run, Galileo would like to see  
9 the CRS business deregulated, but so long as airlines  
10 are made affiliated with the CRS Galileo believes it  
11 is essential that CRS regulations continue. The  
12 potential for abuse by airlines exist today as it did  
13 20 years ago when the CRS rules were initially  
14 promulgated. Indeed, the more things change the more  
15 things seem to stay the same.

16 In a true spirit of deja vu, the airlines  
17 are now attempting to recreate on the Internet the  
18 same CRS abuses that flourished before the rules were  
19 adopted, and although many of the same airlines have  
20 submitted comments in support of deregulations, some  
21 propose tough new regulations to be imposed upon the  
22 non-airline-owned CRSs.

23 Such hypocrisy underscore a propensity of  
24 the major airlines to undermine competition whenever  
25 given the opportunity to do so. As far as the



1 consensus to end Part 255 is concerned, it is  
2 interesting to note that that was not the position of  
3 the prospective owners of WORLDSPAN.

4 Galileo strongly believes that there must be  
5 CRS rules to effectively limit the ability of these  
6 airlines to engage in CRS-related abuses. There is a  
7 particular need for the mandatory participation rule  
8 and the prohibition against discriminatory booking  
9 fees.

10 In support of its position, Galileo has  
11 submitted extensive economic testimony authored by  
12 former Justice Department economists. These  
13 economists conclude that the cost of withdrawing these  
14 rules far outweigh any benefits of eliminating the  
15 rules.

16 It appears that the NPRM is really packaged  
17 for the large airlines based upon a faulty assumption  
18 that CRSs have substantial market power that permits  
19 them to charge super competitive booking fees.

20 What is the basis for this view? Decades-  
21 old analysis or the customary view from the past?  
22 Commoners stating this view as well as the Department  
23 itself merely set the unsupported conclusions of  
24 others. For example, the NPRM says, "The record  
25 appears to suggest that this systems continue to have

1 market power." The Department proceeds to propose a  
2 series of rules changes all designed to give the  
3 larger airlines increased leverage to deal with the  
4 CRSs supposed market power.

5           We are not aware of any recent economic  
6 studies conducted by the Department. The only serious  
7 expert analyses of current conditions in the CRS  
8 business in this docket are the studies submitted by  
9 Sabre and Galileo. The economists incorporated  
10 analysis that Galileo has submitted finds that the  
11 rapid development of alternative distribution channels  
12 gives airlines even more leverage vis-a-vis CRSs than  
13 they had in the past.

14           The authors of the study conclude that CRSs  
15 a responding in a competitive manner to the demands of  
16 their airline and travel agency customers. The study  
17 conducted by Professor Salop of Sabre reaches a  
18 similar conclusion.

19           It is essential that the Department retain  
20 the mandatory participation role and the prohibition  
21 against discriminatory booking fees in order to deter  
22 airline abuses. The Department itself reached the  
23 same conclusion in the draft rules it forwarded to OMB  
24 in April 2002.

25           Some have suggested that the declining

1 airline ownership of CRSs means that these rules are  
2 no longer needed. Galileo strongly disagrees. The  
3 three airline owners of WORLDSPAN say they are selling  
4 their interests, but they have not revealed what  
5 continuing affiliations they will have with the new  
6 owners of WORLDSPAN. The Department should insist  
7 that WORLDSPAN put this information on the public  
8 record.

9           Assuming these carriers retain marketing  
10 relationships, financing support, or other financial,  
11 commercial or strategic affiliations with WORLDSPAN,  
12 they will still have incentives to disadvantage CRS  
13 competition as well as their airline competitors to  
14 the potential damage of consumers.

15           This study by EI confirmed this conclusion  
16 by stating, "Both logic and the available evidence  
17 support the conclusion that marketing airlines can  
18 have the incentive and ability to enter competition by  
19 withholding participation from another CRS."

20           For these reasons, Galileo has urged the  
21 Department to expand the mandatory participation rule  
22 to cover carriers with marketing and other  
23 affiliations. Even if WORLDSPAN breaks completely  
24 from its carrier owners, and from what we have heard  
25 we don't think that will occur, these carriers along

1 with Continental and United will still own Orbitz.

2           We believe Orbitz is already a CRS subject  
3 to the Department's rule. Indeed, on Monday of this  
4 week an article was published confirming a broad roll-  
5 out of Orbitz to travel agents. There is no question  
6 that Orbitz will take full advantage of its status as  
7 an airway-owned CRS if the Department removes the  
8 mandatory participation rule.

9           Without this rule the Orbitz owners will  
10 selectively deny even more content in inventory to  
11 other CRSs, thereby leaving consumers with fewer and  
12 fewer choices.

13           The Department is also proposing to withdraw  
14 the prohibition against discriminatory booking fees in  
15 order to give carriers more leverage against the CRSs.  
16 But many of the comments make clear that this rule  
17 will favor only a few large carriers at the expense of  
18 smaller carriers' competition and consumers.

19           On this point, the EI study concluded that,  
20 "If the existing rule were repealed, the result would  
21 be that large airlines would pay lower booking fees  
22 than smaller airlines, and that such a repeal was  
23 likely to make the smaller airlines worse off in  
24 relative term."

25           MR. REYNOLDS: If I may just --

1 MS. CUPP: Sure.

2 MR. REYNOLDS: The systems sale of other  
3 travel services like hotels, rental cars is not  
4 subject to any requirement that fees be  
5 nondiscriminatory. How much are the fees sold by  
6 different firms in the same industry vary?

7 MS. CUPP: Not that much, and I also  
8 appreciate the fact that 90 percent of the GDS, stuff  
9 going through the GDS is airlines. So it is a small  
10 percentage of what goes through the GDS because we  
11 have over 500 airlines in our system, I don't know,  
12 car rental companies, I mean, maybe 20, and hotels  
13 it's even smaller than that. You know, it's small,  
14 small amounts as compared to the airline inventory.

15 MR. REYNOLDS: Okay.

16 MS. CUPP: The Department attempts to  
17 justify repeal of the mandatory participation rule and  
18 the prohibition against discriminatory booking fees by  
19 citing the market power myth and speculation that  
20 booking fees are too high.

21 Nevertheless, the Department acknowledges  
22 that it has not conducted any study that would support  
23 this conclusion, and the claims of various airlines  
24 that their booking fees have skyrocketed are wholly  
25 misleading.

1           As EI concluded, these claims are  
2 exaggerated and based on false comparison. As explain  
3 the EI study, the functionality and capacity of CRSs  
4 has increased enormously. In short, airlines are  
5 getting far more than they used to. Nevertheless,  
6 Galileo booking fees have remained a small percent of  
7 the revenue generated by sales for Galileo.

8           Moreover, it is highly significant that both  
9 Galileo and Sabre have offered to provide substantial  
10 booking fee discounts to carriers that are willing to  
11 provide access to their web fares. It is interesting  
12 that the three WORLDSPAN owners are the only major  
13 airlines not participating in these programs.

14           Under Galileo's momentum discount program,  
15 an airline that provides its entire public inventory  
16 of fares to Galileo will receive a discount of  
17 approximately 20 percent on fees for bookings made  
18 through participating agencies, and will face no  
19 booking fee increases for a three-year period.

20           In addition, Galileo has introduced a low  
21 Internet booking fee of \$3.50 per segment for tickets  
22 processed on major airline travel agencies.

23           With regard to productivity pricing, the  
24 Department has proposed to eliminate such payments in  
25 order to bring more competitive pressure to bear on

1 CRSs. However, the comments filed by various travel  
2 agency organizations make it clear that CRSs have  
3 provided travel agents with a range of contract  
4 options to fit their needs. These comments show that,  
5 contrary to the Department's assumption, productivity  
6 arrangements do not have an anticompetitive effect.

7           This is consistent with the EI conclusion  
8 that productivity payments are pro-competitive; that  
9 the benefit from these payments flows through to  
10 consumers; and that eliminating productivity  
11 arrangements would have little effect on whether  
12 agencies switch systems or use other booking channels.

13           There is simply no basis for restricting  
14 such ordinary business practices. This is especially  
15 true considering the devastating impact the loss of  
16 this revenue would have on over 100,000 small travel  
17 agencies.

18           Before concluding, I note that Galileo is  
19 puzzled by the Department's apparent determination to  
20 avoid regulating Orbitz. Orbitz is a CRS and is  
21 providing services to travel agencies and businesses  
22 through direct connections to airlines. We urge the  
23 DOT to review the business plans of Orbitz to verify  
24 its goals.

25           It seems clear that the carrier owners of

1 Orbitz have the same incentive to manipulate  
2 competition as it did prior to the original rules.  
3 Indeed, through the most favored nations arrangement  
4 the owners of Orbitz are using Orbitz as a weapon to  
5 control distribution. The NPRM ensures that most  
6 attractive fares of over 40 airlines are available  
7 through the carrier's own distribution channel. This  
8 is a particularly acute problem as airline owners are  
9 otherwise opposed to mandatory participation with  
10 regard to the other CRSs.

11 Galileo submitted with its opening comments  
12 a study by Professor Hausman of MIT showing that since  
13 the Orbitz launch in mid-2001 the Orbitz MFN  
14 arrangements appear to be chewing fair competition to  
15 the harm of consumers.

16 In these circumstances no relaxation of the  
17 rules can be tolerated and they must be applied  
18 equally to all CRSs, including Orbitz.

19 Although Orbitz has reported dramatic growth  
20 in their bookings, Internet pioneer Priceline has  
21 reported a decline in quarterly air ticket sales of 69  
22 percent since mid-2001. Interestingly, hotel rooms  
23 bookings on Priceline during the same period increased  
24 80 percent. Moreover, since the emergence of Orbitz,  
25 no new major online travel agencies have entered



1 successfully, and a number of competitors, such as  
2 once leading Trip.com and Lowestfare.com have been  
3 forced to scale back their plans significantly.

4           It is important to reemphasize this point.  
5 Since the launch of Orbitz no new online agencies have  
6 successfully entered the market.

7           Indeed, despite the sport of a multimillion  
8 dollar marketing effort, Senditstrip.com was not able  
9 to secure enough airline content to penetrate the  
10 Orbitz stranglehold, and was recently driven to  
11 consolidate operations with Cheaptickets.com.

12           Bottom line, because Orbitz functions as a  
13 CRS, DOT needs to close the loop hole and regulate  
14 Orbitz as a CRS.

15           In conclusion, Galileo believes there is no  
16 basis for the rule changes the Department has  
17 proposed. We are simply seeking to ensure a level  
18 playing field, that's all. The economic studies  
19 submitted by government and Sabre show the claims  
20 about CRS market power, and unreasonable booking fees  
21 are not supported by evidence. The unsubstantiated  
22 claims certainly do not provide a basis for changing  
23 your rules.

24           Thank you.

25           MR. REYNOLDS: Thank you. With respect to

1 no new online travel agents, can it be said though  
2 since the dot.com bust and problems throughout  
3 Internet businesses that a lot of other areas might  
4 have experienced similarly where no new entrants have  
5 occurred?

6 MS. CUPP: There was a study. I think it  
7 might have been in Hausman's paper, but that, you  
8 know, of course some of that could be contributed to  
9 it, but also they really do feel that the Orbitz entre-  
10 and the rise, the quick rise with the five largest  
11 airlines in the United States with over 75 percent of  
12 the life in the United States has chilled, has chilled  
13 new entrants as well.

14 And again, you know, from my own experience,  
15 Sendit owns Trip.com and cheap tickets, and despite  
16 multimillion dollar marketing campaign Trip just  
17 couldn't make it on its own because we couldn't get  
18 the fare content. You know, we were locked out of  
19 getting the fare content.

20 MR. REYNOLDS: Some of the airlines claim  
21 that CRS market power is evidence by the fact that  
22 booking fees exist in a dysfunctional market because  
23 reductions in fees do not generate incremental  
24 bookings.

25 What is your response and you can you name

1 any other markets that operate this way?

2 MS. CUPP: Well, I would have to say that,  
3 you know, I would say that we do not have super  
4 competitive booking fees in the market power that they  
5 are alleging, and an example is the changing of the  
6 model through our momentum program.

7 I mean it is not only that the CRS is giving  
8 you, you know, lowering the booking fees 20 percent,  
9 Galileo is lowering it 20 percent, it's also that the  
10 travel agencies that are participating. In order to  
11 get the on-fare web fares are a also giving up some  
12 commission payments. So it is really a change of the  
13 model, and that has showed that the airlines do have  
14 bargaining power to reduce their GDS fees and momentum  
15 locks it for three years, that 20 percent discount for  
16 three years.

17 MR. REYNOLDS: Okay, thank you. Thank you  
18 very much.

19 I think halfway through the morning here on  
20 the number of participants, os maybe we will take a  
21 10-minute break, and be back at 10:25.

22 (Whereupon, a short recess was taken.)

23 MR. REYNOLDS: The court reporter is asking  
24 that anyone who is presenting would please provide her  
25 with a business card to assist her as well, and I

1 think we shall proceed.

2 Orbitz.

3 MR. DOERNHOEFER: Good morning. My name is  
4 Gary Doernhoefer, general counsel of Orbitz. I have  
5 provided my business card to the court reporter. I  
6 don't feel like spending five minutes spelling my last  
7 name.

8 THE COURT REPORTER: Pardon me. You  
9 microphone fell down. Excuse me, sir.

10 MR. REYNOLDS: Sure.

11 MR. DOERNHOEFER: Once again for the record  
12 over here my name is Gary Doernhoefer. I am the  
13 general counsel of Orbitz. Thank you for the  
14 opportunity to appear before you this morning.

15 You have heard today from some who now sell  
16 CRS services, meaning the large CRS companies, and we  
17 will hear from some who now buy CRS services, meaning  
18 the airlines, later today.

19 Orbitz is neither. We are an online travel  
20 agent. We operate in a highly competitive Internet  
21 travel marketplace.

22 If you decide as a matter of public policy  
23 that you want competition in the CRS marketplace, the  
24 likeliest source of that new competition is those who  
25 today offer similar services on the Internet, possibly

1 Orbitz, possibly others.

2           The two key questions before the Department  
3 are: Do you want there to be effective competition in  
4 the CRS marketplace? And if so, what do you have to  
5 do to allow that to happen?

6           We have had for over 18 years CRS rules  
7 which recognize that the CRS business was  
8 characterized by a high degree of market power, and a  
9 low degree of competition, which assumed it was not  
10 possible to change that situation, and which attempted  
11 to limit some of the abuses of that market power.

12           Continuing with that approach is one option.  
13 However, the Department did not previously have the  
14 option of relying on competition as opposed to  
15 economic regulation to discipline the marketplace.  
16 Today it does.

17           The development of travel on the Internet to  
18 the point where it is the most successful sector of e-  
19 commerce today and is a highly competitive marketplace  
20 to the great benefit of consumers means that there is  
21 now for the first time the technology and the  
22 potential entrants to make the CRS marketplace  
23 effectively competitive.

24           But that option will only be achievable if  
25 the Department knocks down the barriers to competition

1 that the largest CRSs have put around themselves,  
2 sometimes with the help of the very rules intended to  
3 limit abuses by CRSs.

4           In the CRS marketplace we have had for 18  
5 years of regulation without -- we have had 18 years of  
6 regulation without competition. We know what that  
7 produces: CRSs that prevent their users, the travel  
8 agents, from using or switching to any other system  
9 easily. CRSs that could bias displays if not  
10 prevented by rules from doing so, because their users  
11 did not have the option of switching to less biased  
12 alternatives. And CRSs that overcharge their  
13 customers, the airlines, because those airlines have  
14 no alternative way to reach the travel agents under  
15 contract to that CRS.

16           This is a system that has not worked to the  
17 advantage of anyone but the CRSs and which we should  
18 no longer perpetuate.

19           The existing rules result in the airlines  
20 and ultimately passenger paying excessive prices for  
21 CRS services, and travel agents being denied the  
22 benefits of choice in competition among CRSs, and  
23 being denied the access to Web fares because their  
24 CRSs refuse to adequately negotiate more reasonable  
25 fees with the airlines, and it results in passengers

1 being denied even wider access to Web fares because  
2 the CRSs sit behind their market power barricades and  
3 refuse to adequately compete on price to get them the  
4 access to Web fares consumers demand.

5 MR. REYNOLDS: Mr. Doernhoefer, a lot of the  
6 CRSs and other say that there is no market power  
7 because of the very existence of Orbitz and similar  
8 entities.

9 How do you respond to that contention? I  
10 mean, you are obviously a vibrant company, but how do  
11 you respond to their using you to say, well, we don't  
12 have market power anymore because of the very  
13 existence of Orbitz?

14 MR. DOERNHOEFER: There are really two  
15 answers to that. Structurally, as I think one of your  
16 questions pointed out earlier this morning, there is a  
17 core of consumers who will choose to use traditional  
18 travel agents for their travel. Today, the Internet  
19 only penetrates at most 30 percent of all air tickets,  
20 which means there are 70 percent that are being sold  
21 through other means; the vast majority of that through  
22 travel agents today.

23 To the extent that a CRS controls the travel  
24 agent, and the travel agents still dominate a  
25 significant number of passengers, there is no other

1 alternative yet in the marketplace that allows the  
2 airlines to get to that group of passengers.

3           Second, and just in terms of evidence of the  
4 fact of market power, you need only look at reported  
5 financial results. For 2002, Sabre, for instance, a  
6 publicly reporting corporation, shows very strong  
7 double digit profit margins in the 20 percent range at  
8 the same time that the airline industry and travel  
9 agents have been suffering dramatically.

10           This suggests that they have the ability to  
11 continue to price their product irrespective of market  
12 conditions.

13           MR. REYNOLDS: Will there be some magic  
14 percentage number in terms of tickets sold online  
15 versus through travel agents or through the CRSs,  
16 rather, that are directly, some combination that will  
17 say there is no longer market power, clearly that a  
18 transition has occurred and the market is now  
19 fundamentally changed?

20           MR. DOERNHOEFER: I'm sure that professional  
21 economists could try and give you the right percentage  
22 number. But another way to look at it, particularly  
23 from a regulatory standpoint, is to eliminate some of  
24 the aspects of market power -- some of the aspects of  
25 the industry that allow the market power to be



1 perpetuated.

2           For instance, if CRSs were obligated to  
3 allow travel agents to switch immediately from one  
4 system to another, literally customer by customer, you  
5 wouldn't need to worry about percentage because that  
6 travel agent would no longer be locked in to a single  
7 CRS. They could book one ticket by the Internet and  
8 the next ticket through the CRS. The market power  
9 aspect would be dramatically and almost immediately  
10 eliminated.

11           Some now propose that we have no CRS  
12 regulations at all. Instead of regulation and no  
13 competition, this would give us no regulation and no  
14 competition for reasons I will discuss further in a  
15 moment.

16           The CRSs would be disciplined neither by  
17 government nor by the market. That would produce  
18 airlines and ultimately passengers paying excessive  
19 prices for CR services, travel agents being denied  
20 benefits of choice and competition even more than they  
21 are today because even the limited rules we have today  
22 on the issue of contract abuse of travel agents by CRS  
23 also would be swept away, and agents and their  
24 customers continually to be denied access to Web fares  
25 because their CRSs would continue to refuse to

1 negotiate more reasonable fees with the airlines to  
2 get those Web fares.

3 MR. REYNOLDS: Mr. Doernhoefer, how do you  
4 respond to the claims though, I mean, with respect to  
5 market power that price competition for the business  
6 of airlines is alive and well as evidenced by the fact  
7 that two of the CRSs have offered discounted fees in  
8 recent years and agreed to freeze those fees in  
9 exchange for such things as fix-term agreements and  
10 access to Web fares?

11 MR. DOERNHOEFER: I think what that shows is  
12 the very nature stages of genuine price competition,  
13 but I would suggest to you a good way of measuring  
14 whether we are really there or not is in the yield  
15 that is offered by Orbitz to the airline industry  
16 through our charter associate agreement.

17 We offer a discount on -- effectively a way  
18 of discounting the booking fee cost to the airline by  
19 30 percent, and a declining cost on a service fee over  
20 time.

21 What's been offered by the traditional CRSs  
22 so far is dramatically less than that. It is no more  
23 than a 10 percent discount, and it is locked in over  
24 time. So what that suggests, that spread between the  
25 deals suggests the premium that the CRSs can still

1 achieve because of their market power.

2 Regulation without competition has not  
3 worked. Deregulation without competition will not  
4 work. The central issue here is thus not regulation  
5 versus deregulation; it is how do we introduce  
6 competition into the CRS marketplace. Whatever else  
7 we do here will work only if we take this present  
8 opportunity to make the CRS business effectively  
9 competitive.

10 What would it take to accomplish that?

11 First, we must understand the nature of the  
12 CRS market power problem that has existed for over two  
13 decades, and that has never been corrected. Each  
14 large CRS has market power because it represents the  
15 only way to sell through a large number of travel  
16 agents. Most of the agents under a contract to a CRS  
17 cannot switch to or use another system to sell  
18 tickets.

19 If an airline does not sell through its CRS,  
20 it will not reach the thousands of travel agents who  
21 are under contract to that CRS or the consumers they  
22 represent. It cannot reach many of the customers of  
23 those travel agents by alternative means. No airline  
24 dependent on CRSs for a significant portion of their  
25 sales could afford to lose the revenues associated

1 with all the travel agents under contract to any one  
2 large CRS for any length of time.

3 MR. REYNOLDS: But do you think that any CRS  
4 could afford to lose say an American Airlines if they  
5 were perhaps in one of their hub cities, Miami or  
6 Dallas?

7 MR. DOERNHOEFER: That's a good question.  
8 You will note the end of my sentence I said for any  
9 length of time.

10 Over the long term it is a symbiotic  
11 relationship. Each needs the other in order to be  
12 successful. But in the short term, that is, for a  
13 week, let's assume that Sabre decides to turn off a  
14 given airline, say an America West, there is no chance  
15 of survival for the end of that week for an airline  
16 like An America West or even American Airlines that  
17 would lose 20 or 30 percent of its revenue at this  
18 stage at this time for the airline industry.

19 So yes over the long term those negotiations  
20 may be balanced, but today, given the state of the  
21 airline industry and, frankly, the relatively health  
22 of the CRS industry, the timing of those negotiations  
23 is all in favor of the CRSs.

24 The Department now has the option of  
25 actually solving the problem of market power by

1 knocking down the barriers and letting new competition  
2 in. If it does that, it will soon find itself in a  
3 position where no CRSs rules are needed. But to get  
4 there it must first knock down the barriers, keeping  
5 new competitors out of the CRS business, otherwise we  
6 end up with the worst of all possible worlds -- no  
7 regulation and competition.

8           We know it is possible to run an automated  
9 distribution system without binding users to that  
10 system alone. We do it every day. It is how the  
11 Internet works. Users on the Internet are free to  
12 look at many different travel Web sites, book on any  
13 Web site that best meets their needs, and make their  
14 next booking on another site that they prefer.

15           That is exactly what most travel agents  
16 cannot do, and it is the root of all evil in the CRS  
17 business. The user is denied ongoing market choice.  
18 That is why there is a longstanding market power  
19 problem in the CRS business, and not in the travel Web  
20 site business. In one the user is trapped; in the  
21 other the user has ongoing market choice.

22           The fact that Internet users can easily shop  
23 around and can easily book wherever they choose each  
24 time they book is what made it possible for a new  
25 entrant, Orbitz, to win business by offering a lower

1 price, exactly what needs to be able to happen for any  
2 market to be competitive.

3 MR. REYNOLDS: Mr. Doernhoefer, does the  
4 most favor -- the so-called most favored nation clause  
5 of Orbitz, does this impede new online entry as  
6 previously alleged?

7 MR. DOERNHOEFER: There is no reason to  
8 believe that the provisions of our charter associate  
9 agreement bar new entry. I mean, let me suggest to  
10 you that there has been no new entry in the CRS  
11 business in something on the order of 20 years, and  
12 yet they are here before you today contending there is  
13 no market power.

14 The fact is that we entered the market at  
15 what turned out to be at just the right moment, before  
16 the dot.com bubble burst. We did so with a new low-  
17 cost strategy. I mean, frankly, very much like what I  
18 just heard Hewlett Packard is now building for Sabre;  
19 that is, serial processors that have scaleability. We  
20 did it already. We did it at a lower cost. It  
21 allowed us to offer a lower cost structure to the  
22 airline industry and win access to their Web fares and  
23 therefore a great deal of popularity among the  
24 consumers.

25 MR. REYNOLDS: Well, speaking of CRS

1 competition, if Aqua successfully markets Orbitz to  
2 travel agencies, wouldn't that create the same  
3 situation of airline-controlled reservation systems  
4 that caused the CAB to adopt the CRS rules in the  
5 first place?

6 MR. DOERNHOEFER: Well, let me first of all  
7 make sure that we're all speaking with the correct  
8 facts because the article that came out just recently  
9 is incorrect.

10 Today the product we offer through Aqua does  
11 not offer the travel agent any means of placing a  
12 booking through any Orbitz system. Today it is  
13 nothing other than a fare check mechanism. So while  
14 the run a search in their -- in whatever GDS they  
15 operate, next to that a window that is created by the  
16 Aqua software a fare check mechanism using Orbitz and  
17 its database is running as well.

18 But once they see another fare in Orbitz,  
19 there is no mechanism by Orbitz to place the booking.  
20 So today it is nothing other than another source of  
21 data to check against their GDS.

22 MR. REYNOLDS: Is there a plan to make that  
23 connection to allow the booking to happen?

24 MR. DOERNHOEFER: We would take that next  
25 step, so-called phase II in our plan, only in the

1 event that the regulations that we're talking about  
2 here today are changed in such a way that we could  
3 enter it without the barrier that the mandatory  
4 participation rule puts up. So there is the plan that  
5 but only depending on the outcome of this proceeding.

6           Second, we need to understand what would  
7 happen to the CRS if the CRS rules were eliminated,  
8 when the CRSs still held the market power they do  
9 today. CRSs could and would dictate terms to airlines  
10 that would bar new competition in the CRS business.  
11 They would do so because they could. The airline, for  
12 the reasons just discussed, could not afford to be  
13 thrown off that CRS and lose access to all the agents  
14 under contract to that CRS.

15           MR. REYNOLDS: Mr. Doernhoefer, I'm afraid  
16 your time has arrived. Thank you very much.

17           (Laughter.)

18           MR. DOERNHOEFER: You know, he's been saying  
19 that for a long time.

20           (Laughter.)

21           MR. DOERNHOEFER: Thank you.

22           MR. REYNOLDS: Thank you.

23           America West.

24           MR. COLE: Good morning, Mr. Reynolds and  
25 the panel. Thank you for inviting us to participate



1 this morning. My name is Ron Cole. I am vice  
2 president of sales with America West Airlines, and  
3 with me this morning are a few people. We have got  
4 our inside counsel, Michelle Matheson, and we also  
5 have our Washington counsel from Baker & Hostetler,  
6 Joanne Young and David Kirstein.

7           America West has submitted both comments and  
8 it's planning on submitting reply comments with regard  
9 to the Department's notice of proposed rulemaking.  
10 Our position on all of the proposed rule changes  
11 reflects our belief that, number one, the CRS continue  
12 to play a critically important role for most airlines  
13 in the distribution of their product. The evidence of  
14 this is that even with the development of alternative  
15 distribution channels, such as airline Web sites,  
16 substantially more than 50 percent of all airline  
17 bookings still are process through a CRS.

18           And number two, before getting into my  
19 specific comments, contrary to both written comments  
20 and comments that you have heard this morning, the  
21 contention that a carrier such as America West has any  
22 ability to negotiate or bargain with a CRS is just  
23 ridiculous. The terms are dictated and the price is  
24 dictated as well.

25           The Computer Reservation Systems have had

1 and continue to have market power over most airlines.

2 In the case of America West, they have monopoly power.

3           Why? Because the CRS vendors know that for

4 the foreseeable future we have no choice but to

5 continue to offer our product through their systems.

6 Dropping out even the smallest CRS could mean the loss

7 of \$50 million in revenue to America West. This is

8 clearly an unacceptable penalty that we would have to

9 pay.

10           As mentioned, our positions on the various  
11 rulemaking issues reflect these two points. The CRSs  
12 are very important to our distribution system, and  
13 they wield monopoly power over us.

14           Given our time constraints, rather than  
15 attempting to explain and defend our positions on each  
16 of the proposed rules, we prefer to highlight a timely  
17 and contentious action that has recently taken place  
18 by one of the CRSs. We believe that this action will  
19 clearly demonstrate the monopoly power of the CRSs  
20 even over a very well financed and powerful company.

21           By way of background, America West has been  
22 working diligently to find alternative distribution  
23 channels that avoid the efficient but very expensive  
24 CRSs.

25           An example is our own Web site. We are also

1 working on web-enabled booking capability that will be  
2 specifically tailored for corporate accounts and  
3 travel agencies.

4 Consistent with this effort to move away  
5 from CRSs, America West entered into an agreement with  
6 Orbitz to distribute our services through their direct  
7 connect program, which is officially called "Supplier  
8 Link." The direct connect enables America West to  
9 receive passenger bookings directly form Orbitz  
10 without incurring the CRS middleman expenses.

11 Both Orbitz and America West have been  
12 working on the automation needed to consummate the  
13 Supplier Link, and we had expected to have it up and  
14 running in the late May, early June time frame.

15 The Supplier Link product would result in a  
16 cost to America West of about \$4 -- well, not about --  
17 specifically \$4 per passenger name record versus the  
18 average CRS charge of about \$10. That is a 60 percent  
19 savings.

20 Direct connect programs like this allow  
21 America West Airlines or will allow America West  
22 Airlines to keep its costs low and continue to operate  
23 low fares to our customers.

24 Last month we were advised by Orbitz that  
25 WORLDSPAN, the CRS used by Orbitz for its bookings

1 that do not utilize Supplier Link, had subverted  
2 Orbitz and its customers' efforts to find a more  
3 economical way to do business. As explained to us by  
4 Orbitz, WORLDSPAN presented Orbitz with an ultimatum:  
5 Either sign the new agreement that guaranteed that  
6 Orbitz would meet or exceed a minimum level of  
7 bookings through WORLDSPAN or WORLDSPAN would  
8 disconnect Orbitz, effectively putting them out of  
9 business.

10               Orbitz had two choices at this point. The  
11 first is that they could have refused WORLDSPAN's  
12 demands, and if WORLDSPAN followed through on their  
13 threat, then Orbitz could not have been able to book,  
14 could not have been able to make bookings with 90  
15 percent of the carriers they do business with that did  
16 not have the Supplier Link hooked up. There is just  
17 three carriers that have Supplier Link hooked up. As  
18 mentioned, this likely would have put Orbitz out of  
19 business.

20               The second option was to cede to WORLDSPAN's  
21 demands and agree to new contractual terms that have  
22 the terrible result of driving up America West and  
23 other airline costs.

24               I should point out that there is no  
25 technological need nor rationale that would explain

1 WORLDSPAN's behavior. This action is very simply a  
2 business decision designed to derail a new efficient  
3 and inexpensive distribution channel.

4           The result is less efficiency and higher  
5 costs driven by a CRS making a unilateral decision  
6 simply because it can.

7           This decision creates absolutely no consumer  
8 benefit, absolutely no benefit to Orbitz, and  
9 absolutely no benefits to other airlines. In fact,  
10 all that happens is that airlines are forced to charge  
11 higher prices to consumers so that they can afford to  
12 pay the monopoly rents to WORLDSPAN.

13           Amazingly, WORLDSPAN took this aggressive  
14 action knowing that the Department of Transportation  
15 was in the midst of CRS rulemaking. It appears that  
16 even being under the microscope was not enough to  
17 divert WORLDSPAN's monopolistic urge to squeeze every  
18 last penny out of customers like America West.

19           How was WORLDSPAN able to circumvent our  
20 best efforts at finding and building a better and less  
21 expensive distribution channel?

22           They were able to do it through the monopoly  
23 market power that they have and exercise over not only  
24 airlines such as America West, but also over companies  
25 such as Orbitz.

1                   MR. REYNOLDS: Mr. Cole, if I may just  
2 interrupt.

3                   MR. COLE: Yes, please.

4                   MR. REYNOLDS: Is there any evidence from  
5 the other travel industries booked through the systems  
6 that they engage in practices that distort competition  
7 in those industries?

8                   MR. COLE: Can you just give me that one  
9 more time?

10                  MR. REYNOLDS: Sure. Is there any evidence  
11 from the other travel industries booked through the  
12 CRSs that the CRSs engage in practices that distort  
13 competition in those industries?

14                  MR. COLE: Such as hotels or cars?

15                  MR. REYNOLDS: For example.

16                  MR. COLE: I'm not aware of any.

17                  MR. REYNOLDS: Okay.

18                  MR. COLE: That doesn't mean there aren't  
19 any.

20                  MR. REYNOLDS: Do you contend, does America  
21 West contend that booking fees are excessive or super  
22 competitive?

23                  MR. COLE: Yes, we do.

24                  MR. REYNOLDS: Do you have evidence or data  
25 to support that contention?

1           MR. COLE: Yes, and we presented that in our  
2 comments, and we will resubmit in our further  
3 comments.

4           The situation I have just overviewed is  
5 incredibly frustrating for America West Airlines. It  
6 drives unnecessary cost and forces us to behave in  
7 ways that are inconsistent with normal business  
8 principles. It also forces us to charge higher fares  
9 to consumers than would otherwise be necessary.

10           Interestingly, this diversion of bookings  
11 back through WORLDSPAN has been named "throttling,"  
12 and we certainly fee throttled by what we see as  
13 monopolistic anticompetitive behavior by WORLDSPAN.

14           If there was any doubt in your mind that the  
15 CRS vendors still possess unhealthy monopoly market  
16 power over their customers, I hope this obvious and  
17 successful use of that power will convince you that  
18 continued regulation is critically important.

19           IN America West's view the five most  
20 important actions the Department can take are:

21           One, readopt the rule on nondiscriminatory  
22 pricing; two, adopt a zero booking fee rule, and let  
23 me just explain on that for a moment.

24           First of all, I think it's interesting that  
25 both American Airlines, the largest carrier in the

1 U.S., and America West, one of the smallest carriers  
2 in the U.S., have both supported a zero booking fee  
3 rule. You have heard of some technological  
4 developments that are taking place as we speak, and a  
5 zero booking fee rule could certainly bring normal  
6 marketplace competitive environment to the CRS market  
7 while these alternative booking capabilities are being  
8 developed.

9 MR. REYNOLDS: Wouldn't a zero fee proposal  
10 essentially be giving free services then to the  
11 airlines?

12 MR. COLE: Not at all. The cost of  
13 producing the product, any product, and the cost of  
14 distribution that product are ultimately borne by the  
15 consumer. What a zero booking fee rule would do is it  
16 would match up the buying decision that is right now  
17 the travel agency makes the buying decision, makes the  
18 purchase decision, however they don't pay the bill.  
19 They do not pay the bill. The bill is paid by the  
20 airlines. So one person makes the buying decision,  
21 the other person pays the bill.

22 So ultimately either way the consumer pays  
23 for that distribution as well as the development of  
24 the product.

25 MR. REYNOLDS: What would the effect of the



1 zero fee proposal be on travel agents?

2 MR. COLE: Well, again, ultimately the cost  
3 of distribution is paid by the consumer. We further  
4 suggested, further recommended that the travel agency  
5 be able to specify the booking fee on the ticket  
6 itself. Right now, right now the CRS fee that is  
7 ultimately borne by the consumer is not transparent.  
8 I mean, the consumer cannot see that charge.

9 If we adopted the zero booking fee rule, and  
10 that fee was put on the ticket itself, the consumer  
11 could clearly see the amount of money that was being  
12 paid back to the CRS for distribution.

13 MR. REYNOLDS: Okay.

14 MR. COLE: Number three, prohibit the sale  
15 of marketing information data; number four, prohibit  
16 productivity pricing; and number five, protect the  
17 airlines' right to control their choice of Internet  
18 sales outlets.

19 Most importantly, we feel that it's  
20 important for the DOT to stay involved in the  
21 regulation of CRS. CRS have a monopoly power and have  
22 shown, as witnessed by this most recent example that I  
23 just gave you, that they can and will wield that power  
24 to the detriment of their customers and to the  
25 traveling public.

1 Can I answer any questions?

2 MR. REYNOLDS: Yes. With respect to the  
3 data, the MIDT data?

4 MR. COLE: Yes.

5 MR. REYNOLDS: Have large airlines used such  
6 data to pressure travel agencies into stopping sales  
7 on smaller competitors? And if you believe that's the  
8 case, can you document that?

9 MR. COLE: America West certainly feels that  
10 that is the case. That is how MIDT is used by  
11 carriers to understand the total size of the market  
12 and to understand within the individual travel agency  
13 or a group of travel agencies where those bookings are  
14 going.

15 Documenting that that has happened is  
16 incredibly difficult. However, we certainly feel that  
17 it is happening.

18 MR. REYNOLDS: Okay.

19 MR. COLE: Thank you very much.

20 MR. REYNOLDS: Oh.

21 MR. COLE: Yes.

22 MR. REYNOLDS: I thought you still had some  
23 more. Just one moment.

24 Why should non-airline systems be regulated  
25 if the tie between, the vertical tie, the ownership

1 has been cut for most of them, what's the  
2 justification for regulating non-airline-owned CRSs?

3 MR. COLE: Well, the rationale would be that  
4 whether or not an airline is involved in the ownership  
5 of a CRS, the CRS still has incredible market power  
6 over a carrier such as America West, and the airline  
7 ownership issue is irrelevant in that regard.

8 MR. REYNOLDS: Okay. Thank you very much.

9 MR. COLE: Thank you for your time.

10 MR. REYNOLDS: Next we have American  
11 Airlines.

12 MR. WARK: Good morning. My name is Bruce  
13 Wark, spelled W-A-R-K. And I am here today on behalf  
14 of American Airlines.

15 The two most significant developments in the  
16 CRS industry since 1992 have been the decisions by the  
17 airlines to sell their CRS interest, and the explosion  
18 of incentive payments that CRSs are now making to  
19 travel agents.

20 We have heard the CRSs argue that the  
21 airlines exit the CRS business, and their intense  
22 competition for the placement of their systems with  
23 travel agents eliminates the need for continued  
24 regulation.

25 However, by narrowly focusing on the

1 question of CRS ownership and really the undisputed  
2 fact that there is intense competition for travel  
3 agents, what they are doing is they are inviting the  
4 Department to ignore the very real and continued  
5 problems of lack of competition among CRSs for airline  
6 participation and the CRS market structure that is  
7 inherently perverse.

8           In the short time I have available today I  
9 want to make three points.

10           The first is that the CRS market is  
11 fundamentally flawed, and it cannot be expected to  
12 work efficiently in a deregulated environment.

13           The second point I want to make is that CRS  
14 market power continues to persist, and the arguments  
15 to the contrary that have been made by the CRSs are  
16 flawed.

17           The last point I want to make is that the  
18 least intrusive, yet most deficient regulatory  
19 solution to this problem is to implement what the  
20 Department of Justice recommended a year ago, and that  
21 is nothing more than to require the travel agents who  
22 select the CRS to pay for the CRS.

23           With this regulatory response, we don't  
24 believe any other further regulation is neither  
25 justified nor needed.

1           If the Department is unwilling to make this  
2 fix, however, parity clauses and all forms of  
3 incentive payments to CRS subscribers must be banned  
4 if market forces are to have any hope of disciplining  
5 the CRS pricing to airlines.

6           Let me go right to the first point which is  
7 the misaligned CRS market. That market as it's  
8 currently structured is plagued by perverse  
9 incentives, persistent CRS market power, and excessive  
10 booking fees. These ills are the natural and  
11 inevitable consequence of a fundamental flaw that the  
12 Department of Justice identified over a decade ago  
13 during the first Bush administration, and that is  
14 simply this misalignment of the CRS purchasing  
15 decision which is made by the travel agent at the time  
16 it selects and uses the CRS, and the payment  
17 obligation, which is made later and borne solely by  
18 the airlines.

19           The point is, is before any market can be  
20 expected to operate and create efficient outcomes and  
21 competitive pricing the decision-maker who generates  
22 demand has to have an economic interest in the price  
23 charged; otherwise the market is bound to fail.

24           Completely deregulating the CRS market in  
25 its current form, therefore, is not going to unleash

1 new competitive forces. What it's going to do is it's  
2 going to unleash the perverse incentives that already  
3 exist in this misaligned and broken market structure.

4 MR. REYNOLDS: Mr. Wark, do you believe that  
5 market power alone is a sufficient legal basis for DOT  
6 to regulate the behavior of CRSs, especially ones that  
7 are independent of airlines?

8 MR. WARK: Yes, I do. The market power is  
9 clearly distorting airline competition today. It  
10 distorts airline competition between major network  
11 carriers and the smaller point-to-point carriers who  
12 don't rely upon travel agents and CRSs.

13 And the other point I would encourage the  
14 Department to think about is to, you know, consider a  
15 proposal suggested by Sabre back in 2000, which is  
16 that to the extent there is distortion being caused by  
17 CRS market power, and we believe it clearly is, the  
18 Department can regulate both the conduct of airlines,  
19 excuse me, the conduct of airlines and travel agents  
20 for contracting with CRSs. So you clearly have the  
21 ability to deal with this problem, and the problem is  
22 very real.

23 MR. REYNOLDS: Based on your answer and as a  
24 matter of consistency, then wouldn't you have to agree  
25 that DOT can similarly regulate the behavior of any

1 airline that is found to have market power?

2 MR. WARK: If you -- the antitrust laws will  
3 clearly restrict any market power abuses that are in  
4 the nature of an antitrust violation. So I mean,  
5 that's the environment that we have always lived in,  
6 so I don't consider that anything new.

7 The point I want to make is completely  
8 deregulating the CRS market in its current form is not  
9 going to give rise to any competitive forces. It's  
10 going to unleash the perverse incentives of this  
11 broken structure. Importantly, no commenter can cite  
12 any example of a deregulated market working  
13 efficiently wherein purchasers are indifferent to the  
14 price, and that of course really understates the  
15 problem with the CRS market, because the travel agents  
16 who consume CRS services are actually being paid by  
17 the CRS to consume them.

18 We know of no comparable circumstance in  
19 which a consumer of a service is paid by the producer  
20 for its consumption.

21 The comments that are already before the  
22 Department clearly illustrate the inefficiencies and  
23 ill-effects of this CRS market structure. To use  
24 Sabre's words, the competition among CRSs for travel  
25 agent subscribers is so robust that travel agents

1 typically pay nothing to use a CRS, and are, to the  
2 contrary, paid for using the systems.

3           In fact, when you look at the numbers, you  
4 will see these incentive payments are now a dollar to  
5 \$1.53 booking and have been increasing at an  
6 astonishing rate of 30 to 50 percent annually.

7           The CRSs argue ironically that these out-of-  
8 control costs justify escalating booking fees. What  
9 they fail to acknowledge is that these payments only  
10 show that the CRS market is not a rational or properly  
11 functioning market. The Department needs to be asking  
12 itself what are the CRSs buying for these payments,  
13 and the only answer is that the CRSs are purchasing  
14 the loyalty of the travel agent to a high-cost system  
15 that the airlines are forced to pay for through the  
16 exercise of CRS market power.

17           To put it plainly, the CRSs have a strategy  
18 of purchasing the loyalty of agents and protecting  
19 their market power through the excessive booking fees  
20 they are able to generate today, and importantly,  
21 there is no reason to expect that this strategy or its  
22 misdirected incentives are going to disappear in a  
23 deregulated environment.

24           In this regard the CRSs like to point out  
25 that WORLDSPAN's prices are not significantly



1 different from theirs, and they ask the Department to  
2 infer from that fact that the prices must be  
3 reasonable because WORLDSPAN is owned by airlines.  
4 There is, however, much more logical answer to why  
5 neither WORLDSPAN nor any other CRS has ever adopted a  
6 low-cost strategy.

7           In the misaligned market there is no  
8 incentive for a CRS to reduce booking fees, and in  
9 fact such a strategy would only reduce the market  
10 share of that CRS --

11           MR. REYNOLDS: If I may interrupt. If the  
12 owners of the CRS are airlines, don't they benefit by  
13 reduced booking fees?

14           I mean, when they were all owned by  
15 airlines, why didn't the airlines drop the booking  
16 fees if it was such a concern to the airlines?  
17 Wouldn't that go straight to their bottom line?

18           MR. WARK: Sure, and the answer to your  
19 question is the misaligned market that I want to touch  
20 upon. The problem with that is, is if you  
21 unilaterally lowered your booking fees that you had  
22 available to you to finance the placement of your  
23 system in travel agents, you would become a less  
24 effective CRS.

25           And so the problem is, is that as you reduce

1 booking fees you got less money to go out to the  
2 travel agents and purchase the placement of the system  
3 there.

4           So if an airline reduced booking fees, there  
5 might be some short-term benefit, but over time its  
6 CRS would become less competitive, so therefore the  
7 only incentive of WORLDSPAN and another CRS is to keep  
8 booking fees high and at least at a competitive level  
9 with regard to the price charged by other CRS.

10           They need to protect that revenue; in other  
11 words, to protect their market share, and that's  
12 because there is this misalignment in the market.

13           If they reduce their booking fees, they get  
14 no additional stimulation because airlines don't drive  
15 demand.

16           The CRSs and the travel agent community try  
17 to justify the incentive payments by arguing that CRS  
18 payments are an increasingly source of revenue to the  
19 travel agents. Thus, I want to take a second to talk  
20 about how important travel agents are to airline  
21 distribution, particularly for a large network carrier  
22 like American.

23           Indeed, the only reason that CRSs have  
24 market power over American is because travel agents  
25 are so important to American. We need travel agents

1 to distribute our product, and many of our customers,  
2 including our largest corporate clients, prefer to use  
3 travel agents.

4 American wants to see travel agents succeed  
5 and bypassing travel agents as a distribution source  
6 is not American's strategy. We do, however, because  
7 we rely upon travel agents, have a very important  
8 interest in seeing that the distribution costs through  
9 travel agents are rational and competitive.

10 In this regard we believe that the demand  
11 for travel agent services should be determined by the  
12 price that airlines are willing to pay through  
13 commissions and the price the consumers are willing to  
14 pay through service fees. Economic efficiency is only  
15 achieved when prices are both transparent and subject  
16 to market tests. It's not economically efficient to  
17 use hidden subsidies from CRSs to prop up those  
18 individual agents whose services are not valued by  
19 either the passengers or the airlines that they  
20 purport to serve.

21 The value that consumers and airlines place  
22 on travel agent services should be determined by the  
23 market, and until that occurs the CRS/travel agent  
24 distribution channel is not going to be cost  
25 competitive.

1           The whole problem of the misaligned market  
2 has really been the elephant in the corner of the room  
3 the CRSs have never really taken on. They do,  
4 however, argue that there are signs that market forces  
5 are alive and well in the CRS distribution. So I want  
6 to take a couple of moments to address the principal  
7 arguments that are made in favor of immediate  
8 deregulation.

9           First, the CRSs argue that their market  
10 power is declining, and they cite the fact that they  
11 are responsible for declining percentage of overall  
12 airline sales.

13           However, if you take a minute to look at the  
14 primary cause of the decline in the CRSs' share of  
15 airline sales, it's primarily driven by the growth of  
16 low-fare, point-to-point carriers like Southwest and  
17 Jet Blue that do not now and never have relied upon  
18 travel agents for the distribution of their products.  
19 In this regard the market and the issues confronting  
20 the Department really are no different than they were  
21 in 1992 when the Department rejected arguments that  
22 the success of Southwest meant that CRSs did not have  
23 market power over other airlines.

24           The Department found then and it remains  
25 true today that Southwest's product and distribution

1 strategy are fundamentally different, and its  
2 experience does nothing to disprove the existence of  
3 CRS market power over network carriers that rely on  
4 travel agents.

5 MR. REYNOLDS: I would like to just explore,  
6 I guess, this point for a moment.

7 MR. WARK: Sure.

8 MR. REYNOLDS: I believe though you do  
9 support removing the ban on discriminatory fees?

10 MR. WARK: Yes.

11 MR. REYNOLDS: Okay. And I guess, part of  
12 that, I guess, supporting that claim was that the ban  
13 was originally established to protect smaller  
14 carriers, and I think in your written comments you  
15 cite the apparent fact that CRSs are now offering  
16 specially tailored products to several smaller  
17 airlines along with lower booking fees as evidence  
18 that the smaller carriers no longer need protection.

19 MR. WARK: Right.

20 MR. REYNOLDS: But if the smaller carriers  
21 are able to get special deals with the CRSs, doesn't  
22 that demonstrate that the CRSs don't have market  
23 power?

24 MR. WARK: I don't believe that Sabre has  
25 market power over Southwest or Jet Blue, and that's

1 exactly why they are able to get deals that are so  
2 much and so different economically than the deals from  
3 the network carriers who do use travel agents.

4 MR. REYNOLDS: Okay. Well, then this -- I  
5 mean, on what basis, legal or policy basis, is the  
6 Department supposed to regulate the CRSs if they have  
7 market power only over one segment of the industry?

8 To put it another way, can the Department  
9 take steps to protect one set of carriers when another  
10 set has been able to avoid the CRS market power and  
11 thrive in the process apparently?

12 MR. WARK: Yes, I believe you do. And the  
13 answer to that question is the mere fact that the  
14 dichotomy exists between the carriers subject to CRS  
15 market power and those that don't proves that there is  
16 going to be harm to airline competition.

17 Right now there is a competitive imperative  
18 for all major carriers like American to bring down our  
19 cost to a level that will make sense. And to the  
20 extent CRS costs stand in the way of that, because  
21 we're still subject to market power, some of the  
22 market power was in fact created by regulation, our  
23 ability to exist and compete with those carriers is  
24 unnecessarily hindered.

25 So the continued market power over network

1 carriers by CRSs will have an adverse impact on  
2 airline competition. And to put this in perspective  
3 we've noted that 70 percent of our sales come through  
4 CRSs. Southwest says 80 percent of its sales don't go  
5 through CRSs. America West puts its figures of sales  
6 going through CRSs at 65 percent, and we expect the  
7 numbers for network carriers would all be  
8 substantially the same.

9           When you go back and you compare these  
10 percentages to historical percentages, you will see  
11 that the percentages of revenues generated by the CRSs  
12 back in 1984 were in fact less than these percentages  
13 that persist today.

14           In fact, it's these persistently high  
15 percentage of sales coming through CRSs that allowed  
16 the CRSs to increase prices in 2003 despite the worst  
17 economic crisis in the history of the airline  
18 industry.

19           I've got more to say, but unfortunately my  
20 time is up. Thank you.

21           MR. REYNOLDS: Thank you very much.

22           Next we have Travelers First.

23           MR. CONRAN: Good morning. How are you? My  
24 name is Jim Conran, C-O-N-R-A-N, and I am here  
25 representing Travelers First, which is an ad hoc

1 coalition of 26 public interest groups located around  
2 the country. We represent senior citizens, small  
3 business owners, people with disabilities, rural and  
4 suburban consumers.

5           The role of these proceedings is to protect  
6 the public, for the public well being. This may come  
7 as a surprise to many people here who are from the  
8 industry, but when consumer groups get together CRSs  
9 are not the first issue we talk about when we talk  
10 about airlines.

11           (Laughter.)

12           Consumers are more concerned about safety,  
13 low-cost fares, access to tickets, to the distribution  
14 system of their choice. They want independent advice,  
15 healthy competition. They want people who can help  
16 them when they have special needs, and they want, when  
17 necessary, aggressive and even-handed enforcement by  
18 government agencies.

19           This issue has become important mainly  
20 because the decisions that the Department makes at the  
21 end of the day, if not done properly, may cause  
22 consumer more money. That's why we are interested in  
23 this particular proceeding.

24           Our position has been that the Department  
25 should reject the notice of proposed rulemaking and



1 proceed to deregulate the market. The prerequisites  
2 to deregulation are two:

3           One, permanent divestiture of online agents  
4 such as Orbitz and CRSs such as WORLDSPAN from airline  
5 ownership or control; and giving the tools for  
6 enforcement to government agencies, such as the  
7 Federal Trade Commission and the Department of  
8 Justice.

9           We did not think if the Department decides  
10 not to take our advice, then we think the Department  
11 should not grant regulatory exemptions for Orbitz or  
12 any other similar entities. We have strong  
13 apprehensions, as others do, about this particular  
14 proceeding. I recognize it's taken several years, and  
15 the industry has changed considerably since the time  
16 this proceeding began.

17           We're concerned and we don't understand why  
18 of all the issues that are important to consumers the  
19 Department has chosen to look at CRSs and travel  
20 agents as the parties that merit or should have new  
21 rules extended to them while eliminating rules that  
22 apply to carriers. We think that this is almost  
23 backwards.

24           We think that the Department should be  
25 looking out for the interest of the public, not the

1 major airlines.

2           In the 1980s when CRSs were owned by  
3 airlines the Department appropriately applied  
4 regulatory constraints and controls over systematic  
5 abuses that were being conducted by the airline  
6 industry. This clearly was the right course of  
7 action. But we are concerned that the Department's  
8 goal should be to keep the airlines out of owning  
9 on/off line ticket distribution systems. That where  
10 problems have been in the past, and that's where they  
11 will be in the future.

12           We think that it's time to bring about  
13 divestiture, and the only way we think that you can  
14 deal with that, even in a fair-handed manner, is to  
15 remove any conflicts of interest such as Orbitz from  
16 the ticketing service industry.

17           Regulation makes sense when there are market  
18 abuses. We have not heard from our perspective that  
19 the CRSs currently are bringing about market abuses to  
20 the public.

21           We think that deregulation and divestiture  
22 will actually bring more people into the market, will  
23 encourage innovation. Competition will bring prices  
24 down. We don't think that the rulemaking proposals  
25 will do that.

1           Again, as I said before, if the Department  
2 chooses though that they want to maintain the CRS  
3 rules, we think that they should apply them to all  
4 participants in the industry.

5           I would like to talk a few minutes about the  
6 needs of consumers and travel agents. I don't  
7 represent the travel agent industry, but I think may  
8 people here sometimes forget, particularly that you  
9 have so many corporate interests here, at the end of  
10 the day what this is all about is the public.

11           There are millions and millions of consumers  
12 in the United States that have difficulty using  
13 airline travel. In poor communities consumers don't  
14 have credit cards. They have to pay cash for tickets.  
15 That eliminates them using online services, where  
16 they don't have computers and Internet access, so they  
17 can't use those systems.

18           I reside in California. Fifty percent of  
19 the households speak English as a second language if  
20 they speak it at all. Consumers have real concerns  
21 and problems in interfacing with the airlines, not to  
22 the airlines' fault, but how many airlines have people  
23 who can speak Mong, which is unwritten language, by  
24 the way. The amount of Southeast Asians in California  
25 are in the millions. And if it wasn't for local

1 travel agents, the same in many Latino communities, or  
2 in the inner cities, if it wasn't for travel agents  
3 consumers couldn't use airline services.

4 We think that this is -- because of these  
5 language constraints, we think the Department should  
6 be more even-handed in their dealings with the travel  
7 agents. We think they play a very valuable role.

8 MR. REYNOLDS: Mr. Conran, if we did  
9 deregulate and eliminated the rules, theoretically  
10 that would allow biasing of displays -- the purchasing  
11 of biasing between the airlines and the CRSs.

12 How would that be a consumer benefit to  
13 those who use travel agents?

14 MR. CONRAN: Well, we don't think that that  
15 necessarily will be the case, and clearly we think  
16 that the Federal Trade Commission and the Department  
17 of Justice and also DOT would have regulatory  
18 authority to crack down on market abuses. So we don't  
19 see that the biasing is an inherent result of  
20 deregulation.

21 MR. REYNOLDS: But doesn't biasing occur in  
22 many other distribution chains, shelf space, you know,  
23 people saying put my product in a better place? Isn't  
24 that fairly common throughout the marketplace?

25 MR. CONRAN: If you are tall, something is

1 up tall, high, does it make a difference? If it's  
2 down low, it doesn't make a difference.

3           So I mean, you know, we're talking about two  
4 different types of industry and different problems,  
5 but a well-intended question, but I don't think that  
6 necessarily deregulation is going to bring about those  
7 types of problems.

8           Again, we do think that the more competition  
9 we have the more people you have in the marketplace  
10 competing for consumers' business, and whether they go  
11 the CRS group, through a travel agent or its  
12 proprietary system through an airline, the more  
13 competition you have we think that will do more to  
14 lower costs for consumers at the end of the day.

15           As I stated before, when I meet with my  
16 colleagues and we talk about industry issues, this is  
17 not an issue we talk about. There are many more  
18 pressing problems for the public.

19           We do think that the Federal Trade  
20 Commission, though, in the area of online has carved  
21 out special expertise in electronic sales of goods and  
22 services across many industries. We think that having  
23 an agency like that would bring in concert the  
24 standards of oversight across these industries for  
25 regulation, always with the objective of putting the

1 consumer first.

2           As I said before, we favor deregulation with  
3 the prerequisites that online ticket agents such as  
4 Orbitz and CRSSs such as WORLDSPAN are divested from  
5 their airline ownership, and we would ask the  
6 Department, if they choose not to deregulation, that  
7 they would treat all the players in the industry the  
8 same way. We think that it's fair, it's even-handed,  
9 and at the end of the day it will be best for  
10 consumers.

11           Any other questions?

12           MR. REYNOLDS: No. Thank you very much.

13           MR. CONRAN: Thank you.

14           MR. REYNOLDS: Next I believe we have United  
15 Airlines.

16           MR. SAWYER: Good morning. I'm Steve  
17 Sawyer, Assistant General Counsel of United. With me  
18 is Ernie Barnicle, who is the director of governmental  
19 affairs for United, and counsel from Wilmer, Cutler.

20           I would like to begin by addressing a couple  
21 of questions that were raised during the presentations  
22 that have been made up to this point; questions that  
23 appear to me to go to the heart of this proceeding and  
24 of the potential for the issuance of rules in this  
25 matter.

1           And the question goes to the existence of  
2 market power, and the question was posed to my friend  
3 at American whether there was, if there was market  
4 power, whether that provided a basis for regulation.  
5 To which he responded yes, with a qualification, and  
6 to which if that question was put to me, I would  
7 respond no, with a qualification.

8           With respect to -- I think what you need to  
9 ask yourself with respect to such a question is what  
10 entity are you talking about that is allegedly  
11 exercising this market power entity or entities. Is  
12 it the airlines, or rather is it CRSs?

13           Well, with respect to the CRSs, the answer  
14 to the question, I believe, is that the agency as we  
15 indicated in our response on this document has no  
16 power, has no legal power to exercise authority over  
17 CRSs standing alone. As I will note in a moment and  
18 as other speakers have noted, that is the state of  
19 affairs largely today. CRSs are no longer airline-  
20 owned or controlled.

21           MR. REYNOLDS: Do you believe that the DOT  
22 has authority to regulate CRSs that are marketed by  
23 airlines?

24           MR. SAWYER: My answer to that is no. I  
25 think the key is control. The typical marketing

1 agreement you will find does not have any element  
2 where the airline that has that relationship has the  
3 ability to control the essential business decisions of  
4 the CRS regarding let's say the exclusion of other  
5 carriers from the system, or other acts that could  
6 have anticompetitive effects.

7           But just to follow through just a little bit  
8 more fully on that response, I think the question too,  
9 once you get beyond the legal argument that we made in  
10 our papers concerning the power of the agency to  
11 regulate a CRS, assuming it had market power, is to  
12 ask the practical question, does it have market power.

13           And we heard the gentleman from America West  
14 suggest that his airline must participate in every CRS  
15 no matter how small or suffer the loss of significant  
16 revenue.

17           On the other hand, it became apparent and  
18 it's obvious to us all in the business that there are  
19 a number of carriers, some of they are very  
20 successful, who do not participate in CRSs at all or  
21 if they do they participate in a very minimal basis;  
22 Jet Blue, Southwest and other carriers come to mind.  
23 Carriers we can only -- carriers like my own can only  
24 dream of the kind of economic success those carriers  
25 have had.



1           But following on the second part of the  
2 question dealing with market power if it relates to  
3 airlines, is there the power of the DOT to regulate,  
4 the answer in this context is no, because the  
5 airlines, as we have noted, no longer have the power  
6 of control over CRSs. If it's a broader context, if  
7 it's dealing with the airlines' conduct vis-a-vis  
8 other competitors in the marketplace, there is the  
9 power under the antitrust laws or conceivably under  
10 Section 411 to regulate.

11           Passing now to my general remarks --

12           MR. REYNOLDS: Well, if may --

13           MR. SAWYER: Sure.

14           MR. REYNOLDS: -- just explore one point and  
15 somewhat related to something you just mentioned.

16           United has not been subject to the mandatory  
17 participation requirement for several years. Have you  
18 tried to get lower booking fees?

19           MR. SAWYER: Well, we have tried and  
20 succeeded. We have a relationship, as has been noted  
21 here, with Sabre. We have an arrangement with Galileo  
22 under which the fees that we are charged are lessened  
23 in return for a valuable service, at least valuable in  
24 their eyes that we provide, but we think that if that  
25 regulation -- if those regulations, mandatory

1 participation and the nondiscriminatory pricing were  
2 eliminated across the board, you would witness a  
3 dynamic where all the carriers and the CRSs, each  
4 having something to offer the other, would engage in a  
5 negotiation which would result in, in our view at  
6 least, more favorable terms on the pricing front.

7           There were questions that you have directed  
8 about evidence of super competitive pricing. From our  
9 perspective, there is an abundance of evidence to  
10 support that idea. My friend at Orbitz suggested that  
11 the margins at some of these CRSs are in the double  
12 digit. Ours are in double digit, but then they are in  
13 the wrong direction.

14           (Laughter.)

15           And in addition, we pay -- we have noted  
16 over the 20 years of existence of the CRS rules that  
17 these CRS fees, booking fees have increased on the  
18 order of some 300 plus percent. Now, we have also  
19 calculated that if the booking fees we paid were at  
20 the rate we pay at Orbitz we would have saved  
21 something between 90 and 100 million dollars in 2002.  
22 That's real money for a carrier like my own, which is  
23 in bankruptcy and struggling to emerge therefrom, so  
24 cost control is key.

25           To pass to a theme that's been struck by

1 others and which I think is essential to appreciate in  
2 this proceeding is to examine the rationale that  
3 existed in 1983 and '84 for these CRS rules, and they  
4 were essentially twofold.

5           One, as has been noted several times here,  
6 the fact that airlines owned the CRSs, United  
7 controlled what was then its own internal system,  
8 Apollo, which became Covea, which became Galileo, and  
9 its degree of control decreased over the years.  
10 American had Sabre. And all of that has ended.  
11 WORLDSPAN is, I realize, in prospect, but every  
12 indication is that that will soon be sold, and the  
13 airline ownership will end.

14           In 1983, the concern was that large  
15 carriers, the dominant network carriers would stifle  
16 competition. You, of course, realize that in 1983 the  
17 Airline Deregulation Act was only four or five years  
18 old. The concern at the time was that small  
19 competitors would be stymied in their ability to offer  
20 services to the consumer at reasonable prices, and  
21 with broadened schedule, and the fear was that the  
22 CRSs controlling this distribution device would stifle  
23 these small carriers from being successful.

24           MR. REYNOLDS: Was that fear justified? Did  
25 that occur at the time when there was ownership?

1           MR. SAWYER: Well, the proof is as plain as  
2 the headline on today's newspaper. In our view, the  
3 carriers that have been successful economically, the  
4 Southwests, the Jet Blues, the AirTrans, and others  
5 have not been successful because of these CRS rules.  
6 Indeed, as we have noted, many of them do not  
7 participate in CRSs. Many of them have found other  
8 devices by which to make their product known to the  
9 public and then sold to the public.

10           And so they have been successful not because  
11 these rules were erected to provide a shield for them  
12 against the perditions of the larger carriers, but  
13 because of their very successful business model, their  
14 successful operational plan, their successful  
15 marketing plan, and most importantly, because of their  
16 ability to control their costs. So that's how I would  
17 respond to --

18           MR. REYNOLDS: So, I mean, was there -- I  
19 guess, what is to stop the vertical ties that were  
20 there with ownership or one of the original  
21 justifications for the rule?

22           What is to prevent other commercial ties,  
23 contractual arrangements, marketing arrangements to  
24 replicate that in dominated cities where a particular  
25 CRS has a large number of the travel agencies, and the

1 airline in question has a large number of the seats in  
2 the market?

3 MR. SAWYER: Well, I think the answer to  
4 that question, I would agree with an aspect that was  
5 put to one of my colleagues who spoke earlier, and  
6 that is that there is no evidence to support the idea  
7 that United or any carrier would engage in those  
8 practices, nothing to support the imposition of rules  
9 that have been in place for 20 years and have produced  
10 very significant economic dislocations.

11 And also when you examine these marketing  
12 agreements, I think you will find that they do not  
13 contain provisions in them that provide the airline  
14 the ability to control the business decisions made by  
15 the CRS in terms of discriminatory pricing or screen  
16 bias or exclusion of other carriers. There is simply  
17 no economic incentive on the part of the CRS to engage  
18 in such arrangements.

19 MR. REYNOLDS: But couldn't the --

20 MR. SAWYER: And so it -- I'm sorry.

21 MR. REYNOLDS: But couldn't the airline  
22 provide that incentive, make it worth their while to  
23 exclude competitors, put bias into the system that  
24 would prejudice the systems against the smaller  
25 carriers in particular cities?

1           MR. SAWYER: Well, I don't -- again, I don't  
2 think that there is any -- I suppose anything is  
3 possible in this world. I don't think there is any  
4 evidence to support that proposition at this point.  
5 Carriers like mine at this moment are struggling to  
6 find the right business model to be successful going  
7 forward, to be sure that their costs are carefully  
8 controlled so that they can return, as we fully expect  
9 to do in a reasonable time frame to profitability.

10           And the idea of engaging in this kind of  
11 practice, expending speculative sums to achieve  
12 uncertain gains is nothing more than sheer  
13 speculation, hardly a sufficient basis upon which to  
14 found the continuation for another period of time of  
15 these rules which, as I note and others have note,  
16 have had serious economic dislocations.

17           I'm going to conclude by repeating a point  
18 that I think because of its criticality in this  
19 proceeding bears repeating, and that is that the  
20 rationale, the basis for, the premise for the *raison*  
21 *d'etre* of the rules in 1983, that is, that airlines  
22 would use their power over CRSs to distort competition  
23 in the marketplace, and deny carriers, small  
24 carriers, low-cost carriers the ability to be  
25 successful no longer exists, and therefore, in our

1 view, the reason for the rules to protect against that  
2 eventuality no longer exists.

3 And when you add to that the economic  
4 distortion which is the result of the rule, which  
5 produces prices for the service, which are super  
6 competitive in our view, we believe that the time has  
7 come to end the rules, and we urge you to do so.

8 MR. REYNOLDS: Foreign CRS rules contain  
9 reciprocity provisions. Are you prepared to forego  
10 anti-bias and nondiscriminatory treatment for the sale  
11 of your services outside the United States?

12 MR. SAWYER: I think the short answer to  
13 that is yes. We are prepared to rely upon the  
14 economic power that we have, such as it is, to arrive  
15 at arrangements with other carriers in other  
16 jurisdictions that work to our economic interest and  
17 also to the interest of those CRS vendors. That's my  
18 off-the-top-of-my-head response. If upon reflection I  
19 have a different view, you can be sure we will offer  
20 it, but that's my view at the moment.

21 MR. REYNOLDS: Fair enough. Thank you very  
22 much.

23 MR. SAWYER: You're welcome. Thank you.

24 MR. REYNOLDS: Well, this is where we would  
25 have our break. I don't know if Delta would be

1 willing to come a little early, and we can knock one  
2 more off, so to speak before the break since we have a  
3 lot more to go in the afternoon than we do in the  
4 morning, and certainly no slight intended.

5 MR. McCLAIN: I appreciate the opportunity  
6 to be knocked off before lunch, and hope that doesn't  
7 foretell the nature of questions I might receive.

8 I am Scott McClain, and here on behalf of  
9 Delta. We appreciate the opportunity also to -- this  
10 additional opportunity to discuss some of the issues  
11 that we believe are the most fundamental and  
12 important. Obviously, we will address many more  
13 issues in our reply comments.

14 But the three, I think, most important  
15 questions that I would like to address this morning,  
16 first of all, is the fundamental question that the  
17 Department must address as it works through this huge  
18 proceeding, which is whether any regulations at all  
19 are required.

20 If the answer to -- and that question turns  
21 on whether the free market forces of competition  
22 supplemented by the normal enforcement of the  
23 antitrust laws are enough to address the market  
24 failures that you're grappling with in these  
25 proceedings, the answer should be no. These rules



1 should be allowed to expire in their entirety.

2           The second question though is if there is a  
3 market failure that those two factors are not  
4 sufficient to address, competition and normal  
5 enforcement of the antitrust laws, then what is the  
6 specific market failure that you're trying to address?  
7 And what is the most narrow rule or rules that would  
8 be sufficient to correct it?

9           That is all the Department should enact in  
10 these proceedings, and rules that starting from  
11 scratch today don't meet that criteria are an  
12 unnecessary government intrusion into the market. You  
13 should let the market work.

14           So finally, third, whatever the Department  
15 decides to do in these proceedings we view this as the  
16 most critical of all. Whatever the Department does it  
17 should not adopt nor should it maintain any  
18 regulations which have the effect of distorting or  
19 suppressing competition; the sort of the physician's  
20 creed here "do no harm." That's the first rule.

21           And I want to address that really in two  
22 contexts that are in front of the Department. The  
23 first being the proposed repeal of the mandatory  
24 [participation rule, in which case our view is that  
25 the Department has got it exactly right. This is a

1 rule that was enacted with the best of intention years  
2 ago, but now operates to distort the market and to  
3 suppress competition. It is doing harm and it is not  
4 delivering the consumer benefit that it was intended  
5 to provide.

6 MR. REYNOLDS: If I may, why should the  
7 mandatory participation rule be eliminated when as a  
8 practical matter it applies to few carriers and may  
9 soon not apply to any?

10 MR. McCLAIN: Well, I intend to address in  
11 more detail as I work through, but the short answer to  
12 that is because it applies to some carriers and not to  
13 others. That is the harm. And those carriers to whom  
14 it applies are prevented from exploiting competitive  
15 options and competitive opportunities that our  
16 competitors are allowed to exploit. It creates  
17 distortions on the market, and I will address it in  
18 more detail.

19 Let me turn first though to the threshold  
20 question of whether any rules at all are required.  
21 It's a surprising variety of commentary on this issue  
22 has come out in the first round suggesting that the  
23 rule should be allowed to expire entirely, and that  
24 perhaps should not be surprising because these rules  
25 are 20 years old, and the landscape that the

1 Department is looking at now is fundamentally changed.

2 Most importantly, of course, is the Internet.

3 And the reason the Internet is so important  
4 and alternative distribution technologies are so  
5 important is because they have broken the monopoly on  
6 travel information. The travel information monopoly  
7 is no longer unique. And what that means is none of  
8 these rules should be maintained unless taken today,  
9 writing on today's blank slate they would make sense.

10 I wanted to discuss this in the context of  
11 the bias rules because I think the bias rules  
12 illustrate this better than any other. It's hard to  
13 defend bias when you use that word, of course, because  
14 bias in and of itself is a derogatory term.

15 But what it really means is preference, and  
16 retailers, as Mr. Reynolds, as you observed earlier  
17 this morning, retailers in every industry do and can  
18 exhibit bias in the brands that they decide to retail.  
19 A grocery store can choose to sell Coke, but not  
20 Pepsi, or give better shelf space to Coke if it wants  
21 to. A car dealer can choose to sell Fords but not  
22 Hondas, and no one suggests that this bias harms  
23 consumers or that the FTC should adopt a rule that  
24 prohibits that sort of bias.

25 And the reason for that is because

1 competition corrects it. If you don't like the brands  
2 that are offered by one retailer, you can simply go to  
3 a different retailer and chose a different set of  
4 brands.

5 Competition solves the bias problem, and the  
6 reason that was not the case in the airline industry  
7 or the distribution of airline services in 1984 and in  
8 1992 is because at that time the CRSs had a monopoly  
9 on travel information, s consumers didn't have the  
10 ability to go to different shops.

11 Each travel agent was essentially locked  
12 into a given CRS, and bias was beneath the surface.  
13 It was hidden from consumers.

14 MR. REYNOLDS: Pursuant to that point, I  
15 mean, what percentage of airline tickets by revenue  
16 are sold by travel agents?

17 MR. McCLAIN: It's different for different  
18 carriers. A significant percentage overall are still  
19 sold by travel agents, but the difference now is that  
20 because the Internet as an alternative source of  
21 information is available, regardless of whether or not  
22 the ticket is sold on the Internet, that source of  
23 information monopoly has been broken.

24 Consumers, as you have observed in the NPRM,  
25 can and do bounce back and forth between travel Web

1 sites, but travel agents can do that too. That  
2 Internet tool is available to travel agents no less  
3 than consumers, and actually our friends at ASTA in  
4 their comments have quantified that. Ninety-eight  
5 percent of travel agents in this country have online  
6 access in their office.

7           The new services that are being made  
8 available by Orbitz and other third-party vendors that  
9 allow searches of the Internet to give travel agents  
10 that chance to check the bias in their GDSs make it  
11 clear that travel agents now and certainly consumers  
12 have the tool to police bias. And if they don't want  
13 bias in their GDS, they can demand unbiased GDS  
14 services, and as we know the GDSs do respond to the  
15 demands of travel agents, unlike carriers.

16           MR. REYNOLDS: Just back to my question, do  
17 you know ballpark Delta's percent of the revenues of  
18 their tickets derived by travel agent sales?

19           MR. McCLAIN: I believe it's slightly under  
20 50 percent now for Delta.

21           MR. REYNOLDS: Thank you.

22           MR. McCLAIN: So with respect to bias  
23 itself, perhaps, you know, the hardest to defend rule  
24 of why it wouldn't be good for the Department to  
25 prevent bias, even with that rule in today's rule

1 writing on a blank slate it is highly unlikely the  
2 Department would conclude that it was necessary to  
3 promulgate the sort of detailed prescriptive rules  
4 that get into very sort of minute level management of  
5 screen displays. The Internet makes that unnecessary.

6           And what we hope that the Department will do  
7 is to take that same sort of analysis on a rule-by-  
8 rule basis -- we'll spend more time in our written  
9 comments doing this -- but to ask the hard question  
10 with respect to each rule, what market failure is this  
11 addressing, and would we really do it if we were  
12 starting from scratch in 2003.

13           The critical question then becomes what is  
14 the market failure that should be addressed by rule,  
15 and the fundamental market failure that the Department  
16 we believe correctly has identified in the NPRM is the  
17 potential abuse by CRSs over their market power over  
18 carriers. It is a function of the peculiar structure  
19 of this industry that has been described over and over  
20 again in the various rulemaking proceedings, but it  
21 has to do with the fact that at least today many  
22 carriers continue to rely on the CRSs and on travel  
23 agents for the sale of a large percentage of their  
24 tickets for various reasons.

25           Travel agents essentially enter into de

1 fact exclusive dealing arrangements with the CRSs,  
2 and therefore exclusion from a CRS would be a disaster  
3 for most carriers. That ability to deny access to its  
4 CRS gives the CRSs tremendous market power over  
5 carriers, and in a showdown between CRS that's making  
6 double digit returns and a carrier that is on the  
7 verge of bankruptcy, as has been pointed out this  
8 morning, the carrier will always blink first if they  
9 are dependent upon distribution through the CRS  
10 channel because they can't afford to be shut out even  
11 for a very short period of time.

12 But the key point that I want to make this  
13 morning is that this dynamic is changing, and the key  
14 is the development of viable alternatives to the CRSs;  
15 not that CRSs would be replaced, but that they would  
16 no longer have that lock, that control on the  
17 distribution channel.

18 In two years of dealing with the CRSs, in  
19 Delta's experience the first time they have begun to  
20 express a serious interest in negotiating with us when  
21 these alternatives began to become viable, and  
22 particularly in the context of Web fares.

23 The development of these new channels has  
24 gotten the CRSs' attention, and that is the key to  
25 long-term competitive health; that is, protecting the

1 development of those alternative channels.

2 MR. REYNOLDS: But isn't it true that the  
3 Internet at this point is an imperfect substitute for  
4 travel agents and their CRSSs, especially for corporate  
5 customers which tend to have complex needs?

6 I mean, in other words, for high-yield  
7 customers who are important to most airlines what  
8 alternative distribution channels exist with  
9 comparable functionality?

10 MR. McCLAIN: Today, I mean, I guess the key  
11 to my answer to that question is how rapidly the  
12 dynamic is changing. The direct connect technologies,  
13 Internet technologies and so on, are they a complete  
14 substitute for travel agents today, clearly not. We  
15 wouldn't be here if they were.

16 But, but they are an important substitute  
17 and they are rapidly becoming a more important  
18 substitute, and more importantly, they are  
19 disciplining the GDSs to be a better service provider  
20 to the carriers, and that trend will continue.

21 That's why we propose this idea of a  
22 transition to deregulation rather than pulling the  
23 carpet out from under this industry immediately. We  
24 don't think that what's important is that the GDSs be  
25 controlled in a short interim transition to a free



1 market from using the atomic bomb, so to speak, to  
2 prevent it from denying carriers access to their  
3 systems if those carriers attempt to develop these  
4 alternative systems.

5           And this is not just simply a hypothetical  
6 concern as American has laid out in their comments.  
7 Sabre has already undertaken a litigation strategy to  
8 do exactly that; taking the position that their  
9 participating carrier agreement requires that carriers  
10 provide them Web fares. Rather than bargaining for  
11 them, they are attempting to get them by force, and  
12 they could certainly use the threat of denial to  
13 Sabre's system as an alternative way of doing that.

14           That's what we think the Department, that's  
15 the market failure that we believe the Department must  
16 correct in the interim to a deregulated market, and we  
17 don't think it is necessary for very long.

18           But finally, let me turn to the last topic I  
19 wanted to address, the whether or not, whatever you  
20 decide to do the do no harm idea.

21           No rule should be adopted if it will  
22 suppress or distort competition. You have proposed  
23 correctly to avoid this in the context of the  
24 mandatory participation rule. That rule creates the  
25 very market failure that you're trying to address. It

1 forces those carriers to whom it applies to purchase  
2 services they may or may not want from every GDS, and  
3 eliminating that rule will allow competition to work,  
4 and will allow carriers to make the choices that, for  
5 example, Southwest has made to limit their  
6 participation in some GDSs if they think that that's a  
7 good competitive strategy.

8           In contrast, in the case of MIDT, the  
9 Department has taken or proposed to take the exact  
10 opposite approach. The Department has not conducted a  
11 thorough investigation of this issue, and it has  
12 proposed -- the NPRM contains virtually no discussion  
13 at all about the most important use that carriers like  
14 Delta make of MIDT, that is, network analysis.

15           MIDT is critical to Delta's route analysis  
16 and network planning. Simply put, we use it to match  
17 capacity to demand. If we were forced to make those  
18 capacity allocation decisions without MIDT, we would  
19 have to use inferior data, and we would make inferior  
20 decisions.

21           Some routes would get too much capacity,  
22 some routes would have too little. We would lose  
23 money on those routes where we had too much capacity,  
24 and consumers who would otherwise have had air service  
25 would be denied it on the routes that didn't get it

1 because we were not able to adequately test and market  
2 demand.

3 We also use it to identify market trends to  
4 determine where we should be offering lower fares,  
5 sales, more aggressive competition.

6 There is no adequate substitute for this  
7 date. The DOT O&D data that's referred to in the NPRM  
8 includes only U.S. carriers, so it's not useful for  
9 international service. It's less accurate because  
10 it's only sampling, and most important of all, it's  
11 subject to very long lag periods that do not apply to  
12 MIDT. We get the MIDT data within 15 days on a  
13 monthly basis, and we rely on it in making competitive  
14 decisions.

15 MR. REYNOLDS: How do you respond to the  
16 allegations that such data has been misused by the  
17 larger carriers against the smaller ones?

18 MR. McCLAIN: First of all, those  
19 allegations -- I can speak with respect to Delta --  
20 they are simply false. But the fact that some carrier  
21 might be able to use a particular source of  
22 information in an anticompetitive way does not mean  
23 that the information should be denied. That's  
24 throwing the baby out with the bath water. It's like  
25 saying because carriers could burn down the hangars of

1 their competitors, no carrier should be allowed to  
2 have gas online.

3           The idea is that if there are instances of  
4 MIDT abuse, which we don't believe there are, but if  
5 there are instances of MIDT abuse, then those  
6 instances can be dealt with under the antitrust laws  
7 and perhaps by the Department in individual  
8 enforcement proceedings under Section 411.

9           There is no need to have a shotgun blast  
10 approach that eliminates access to such a useful  
11 competitive tool which has so many valuable pro-  
12 competitive uses, and I would be happy to answer any  
13 questions that you may have.

14           MR. REYNOLDS: Thank you very much.

15           I guess we will take our lunch break just a  
16 little bit early, and start promptly at 1:00 with, I  
17 believe, Continental. Thank you.

18           (Whereupon, at 11:55 a.m., the hearing in  
19 the above-entitled matter was recessed, to resume at  
20 1:00 p.m., this same day, Thursday, May 22, 2003.)

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1                   A F T E R N O O N   S E S S I O N

2   (1:05 p.m.)

3                   MR. REYNOLDS: All right. Good afternoon.  
4 We will begin the afternoon session with Continental  
5 Airlines.

6                   MR. KAMEN: Good afternoon, and thank you  
7 for allowing Continental to be represented at this  
8 hearing today.

9                   My name is Hershel Kamen, and I am vice  
10 president of international and regulatory affairs for  
11 Continental. With me today is Lorraine Halloway of  
12 Crowell & Moring, counsel to Continental here in  
13 Washington.

14                   Every day more consumers turn to their own  
15 computers to search airline Web sites, online travel  
16 agencies and last-minute inventory outlets rather than  
17 relying entirely on traditional travel agents and on  
18 the four CRSs used by those agents.

19                   As these trends continue, competition will  
20 be able to replace government regulation to deal with  
21 biased displays, excessive booking fees and other  
22 abuses the CRS rules were intended to resolve.

23                   However, as alternate distribution systems  
24 are still in their early stages of development, there  
25 is no effective competition for CRSs today, and it

1 would be premature to replace CRS regulation with  
2 competition now.

3           Therefore, my remarks will focus on why the  
4 Department should adopt a five-year transition before  
5 full deregulation of the CRSs, with a study of airline  
6 distribution two years before such deregulation is set  
7 to happen in order to evaluate the progress towards  
8 deregulation and possible adjustment of the  
9 deregulation time table.

10           Second, why all Internet travel sites must  
11 remain completely free of regulation during the  
12 transition period; how competition, airline efficiency  
13 and consumer service will be enhanced by continued  
14 unrestricted MIDT access; and finally, what other  
15 measures are needed to smooth the transition to full  
16 deregulation.

17           Let me start with the transition period.  
18 Since competition is the best anecdote to CRS abuses,  
19 Continental is a strong advocate of ending CRS  
20 regulation. As a realist, however, Continental  
21 recognizes that the industry is not yet ready for  
22 complete deregulation.

23           The Department cannot simply wave a magic  
24 wand and create a level playing field between the  
25 airlines and CRSs, between subscribers and CRSs, or

1 between the foreign-entrenches CRSs and emerging forms  
2 of airline distribution.

3           The fundamentals of CRS market power remain.  
4   The four CRSs still wield substantial market power  
5 and have undiminished pricing power over airlines.  
6 CRS market power was created decades ago and will not  
7 disappear overnight.

8           A five-year transition period before full  
9 deregulation represents a middle ground between the  
10 extreme positions of those commenters seeking  
11 immediate CRS deregulation and those advocate seeking  
12 regulation for an indefinite period. It will provide  
13 time for alternate distribution channels to reach  
14 their potential before facing totally unrelated  
15 competition by the CRSs. It will provide time for  
16 competition to develop.

17           MR. REYNOLDS: With respect to the market  
18 power of the CRSs, do you maintain that there are  
19 excessive or super competitive booking fees that those  
20 are indicative of such market power?

21           MR. KAMEN: Absolutely. In the case of  
22 Continental specifically, because of being a network  
23 business, because of the way our business model, we  
24 have to be in all four CRSs. We lose our leverage  
25 because of that fact. Because of the fact we have to

1 be there, we lose our leverage, and there is no way  
2 for us to fight excessive booking fees.

3 MR. REYNOLDS: Do you have evidence or data  
4 to support that?

5 MR. KAMEN: We do have data for it. I don't  
6 have it here with me here today. We can put it in the  
7 reply comments.

8 MR. REYNOLDS: That's fine.

9 MR. KAMEN: With a fresh look at the  
10 marketplace in three years, the Department will be  
11 able to see how CRSs and Internet distribution  
12 channels have developed, and determine whether total  
13 deregulation is possible sooner than the five years,  
14 or whether the CRSs have found new ways to block  
15 competition and retain their market power under the  
16 Department's transitional rules.

17 As has been stated many times before,  
18 Internet travel sites are the only effective  
19 competition to CRSs. Competitive forces can only  
20 begin to cure the biased displays and excessive  
21 booking fees that still infect CRSs if Internet travel  
22 sites remain totally free of regulation.

23 Without unfettered competition from Internet  
24 travel sites, CRSs will continue to dominate travel  
25 distribution channels, charge airlines fees far more



1 than the economic value the airlines receive from the  
2 CRSs, and restrict the ability of airlines and  
3 consumers to maximize the number of distribution  
4 channels available to them.

5 CRS competition rests on the shoulders of  
6 the Internet. Regulating any Internet airline  
7 distribution channel would stifle the growth and  
8 competitive benefits of the Internet, require a longer  
9 term regulation of CRSs, and be at odds with the  
10 administration's policy of opposing any restrictions  
11 on e-commerce.

12 The Department has proposed to restrict the  
13 sale of MIDT data. This proposal is unwarranted,  
14 unwise, and unpopular. This data is a critical  
15 planning tool for airlines. Advocates of the  
16 restrictions portray the debate over MIDT sales as a  
17 small versus large carrier issue, but that is simply  
18 not true. There are small and large carriers who  
19 recognize the value of MIDT and support the existing  
20 rule.

21 Another myth advanced by the few opponents  
22 of MIDT sales is that airlines use MIDT to poach  
23 customers from their competitors. This also is simply  
24 not true. That is not the purpose of the data. To my  
25 knowledge, there has never been an enforcement

1 complaint alleging such activity nor has any serious  
2 investigation of such charges occur.

3           Airlines use of MIDT for marketing research  
4 and route development, schedule adjustment, and other  
5 competitive activities. Many communities can credit  
6 their service to the decision-making aid that MIDT has  
7 provided.

8           Allowing airlines to opt in or opt out of  
9 the distribution of their booking data, as proposed in  
10 the notice, would destroy the integrity and usefulness  
11 of the MIDT database, allowing for the deletion of  
12 travel agent data would hurt not only airlines but  
13 travel agents as well. Rewarding travel agent  
14 production would be difficult if there was no way of  
15 keeping the score.

16           MIDT data is an important information source  
17 for airlines of all sizes and restrictions on this  
18 data should not be implemented.

19           To facilitate the transition to a  
20 competitive airline distribution marketplace, the  
21 Department should refrain from adopting new rules that  
22 artificially distort CRS prices or increase airline  
23 and subscriber dependence on CRS. To this end, the  
24 Department should refrain from regulating CRS booking  
25 fees.

1           Even WORLDSPAN admits that the existing ban  
2 on discriminatory booking fees restricts the ability  
3 of airlines to bargain for lower fees, inhibit CRSs  
4 from giving price breaks to carriers whose booking  
5 volumes warrant a discount, and deter CRSs from  
6 adopting innovative price product and service plans.

7           MR. REYNOLDS: But haven't the CRSs offered  
8 discounted fees in recent times?

9           MR. KAMEN: There has been some, some  
10 offerings, and Continental has taken place in some of  
11 those offerings as well.

12           I would say, however, that the fees are  
13 still -- the offerings are small. They are not big  
14 offerings, and the terms are still dictated to the  
15 carriers, so there needs to be, you know, an ability  
16 to negotiate both the terms and the fees.

17           The Department should either abolish or keep  
18 the mandatory participation and nondiscriminatory  
19 booking fee rules. Disparate treatment of these  
20 interrelated rules makes no sense. If both rules are  
21 maintained, the mandatory participation rule should  
22 apply to airline marketers as well as to airline  
23 owners.

24           The Department should prohibit productivity  
25 pricing. Such a ban would counter the CRSs' unhealthy

1 battle for subscribers by precluding the CRSs from  
2 providing substantial discounts to travel agents which  
3 are recouped by the CRSs by charging airlines super  
4 competitive booking fees.

5           The Department should prohibit CRSs from  
6 tying airline participation in the CRSs to system  
7 access to Internet sites and other benefits. The  
8 anti-tying rule must prevent CRSs from using contract  
9 provisions to impose such requirements and must leave  
10 airlines free to use the most cost-effect airline  
11 distribution channels.

12           Finally, the Department should limit  
13 subscriber contracts to one year terms. A one year  
14 maximum term will enable travel agencies to use  
15 multiple CRSs and to switch systems while also  
16 providing sufficient time for amortization of the CRS  
17 costs of providing services and equipment.

18           In closing, the Department's goal should be  
19 full CRS deregulation in five years or earlier,  
20 whenever market forces have become strong enough to  
21 overcome the effects of past CRS abuses and discipline  
22 the current practices of CRSs. Until then the  
23 Department's final rule in this proceeding must foster  
24 a smooth transition to that fully competitive  
25 environment.

1 Thank you.

2 MR. REYNOLDS: How would Continental  
3 implement your ability to participate at a lower level  
4 in some systems rather than others?

5 MR. KAMEN: You know, again the difficulty  
6 for us is that we need to be in all the systems based  
7 on our business model. You know, I'm not prepared  
8 today to discuss whether we would go lower in one  
9 system or another. I guess it's something we would  
10 consider based on the benefits and the cost of doing  
11 that. However, the reality is we have to be in these  
12 CRS systems and that fact is not going to change. So  
13 there won't be, I don't think, wide-scale changes to  
14 how we operate today.

15 MR. REYNOLDS: What about the broader  
16 implications of the international air services  
17 agreements and commitments with respect to CRS rules  
18 in those?

19 I posed the question earlier, if the rules  
20 go away, their reciprocity clauses in foreign CRS  
21 rules, if you advocate eventually total deregulation,  
22 are you willing to maybe face bias in other systems  
23 down the line, in foreign systems?

24 MR. KAMEN: Yes is the simple answer.

25 MR. REYNOLDS: All right. Thank you very

1 much.

2 MR. KAMEN: Thank you.

3 MR. REYNOLDS: Just to repeat, I know that  
4 for those who may not have been here in the morning,  
5 please state your name clearly and spell it, if  
6 necessary, and if you can give a business card to the  
7 court reporter, and please be careful to be sure your  
8 cell phones and pagers are not on audible alarms.

9 US Airways.

10 MR. TRACAS: Good afternoon. I am Steve  
11 Tracas, T-R-A-C-A-S, Vice President of sales for  
12 USAirways.

13 I would like to thank the members of this  
14 panel and the Department for the opportunity to make  
15 our public statements on this important proceedings.

16 USAirways would like to focus the  
17 Department's attention to the main reason why the CRS  
18 rules exist -- for the benefit of the consumer.

19 This is of paramount importance in this  
20 proceedings. It is the reason why the CRS rules were  
21 implemented in the first place, and remains why these  
22 rules are needed to continue to exist.

23 Hopefully by the end of the day after  
24 listening to numerous arguments from numerous parties  
25 on this extended and extremely lengthy and complicated

1 proceedings, and after reviewing all of the reply  
2 comments in the next few weeks, any decision made by  
3 the Department will be based in the interest of the  
4 consumer.

5           There is a clear congressional mandate for  
6 this as the Department is tasked with preventing  
7 unfair and deceptive practices in the airline  
8 industry.

9           Accordingly, there is a compelling reason  
10 why the consumer must be allowed to make airline  
11 purchasing decisions based on complete, neutral, and  
12 biased-free information.

13           Now, in looking at the numerous and  
14 complicated issue presented before the Department,  
15 USAirways believes that all decisions in the  
16 proceedings can easily be answered by asking this one  
17 question: Will this proposed rule be harmful or  
18 beneficial in the consumer's interest?

19           Within this context, USAirways would like to  
20 discuss two issues regarding the proposed CRS rules  
21 which would have a profound impact on the airline  
22 distribution industry.

23           First, the CRS rules are necessary and  
24 should cover Internet distribution channels that are  
25 competitive with CRSs.

1           Second, the mandatory participation rule and  
2 the rule prohibiting discriminatory booking fees must  
3 remain in place.

4           It is clear from the comments filed in these  
5 proceedings that there is recognition that the CRS  
6 rules remain necessary to protect consumer interests.  
7 We note that there are a few in favor of expiration  
8 of these rules or a transition period that will lead  
9 to the expiration of the rules. This view ignores the  
10 fact that the CRS rules were intended to prohibit  
11 abuse of displayed bias from reoccurring in the  
12 future. The fact that CRSs may be free from airline  
13 ownership does not guarantee that CRSs will continue  
14 to independently provide neutral displays in the  
15 future.

16           MR. REYNOLDS: What -- I guess you may have  
17 somewhat -- you may have just covered that. I mean,  
18 as a practical matter, few airlines and perhaps none  
19 will be owners anymore. What does it matter if the  
20 mandatory participation rule is eliminated?

21           MR. TRACAS: It's not only the ownership  
22 issue at stake, it's the marketing agreements that  
23 these airlines have with the CRSs not only in the past  
24 but in the future, and the intent of this ruling is to  
25 protect the consumer from not only what transpired in



1 the past but what might happen in the future, which we  
2 can't foresee at this point in time.

3 MR. REYNOLDS: So would you advocate or are  
4 you advocating prohibiting such marketing or tying  
5 arrangements in the future between the airlines and  
6 the CRSs that are independent?

7 MR. TRACAS: We would advocate those  
8 agreements do not exist if these rules are eliminated.  
9 If these rules are in place, then marketing  
10 agreements can exist.

11 The existence of the rules specifically with  
12 respect to the displayed buyers rules is the only  
13 guarantee that will prevent the consumer from being  
14 confused and from being outright deceived.

15 The CRS rules should continue and should be  
16 expanded to apply to all airline distribution  
17 channels. More specifically, all Internet  
18 distribution channels that are comparable to CRSs  
19 should not be free to bias or displace.

20 MR. REYNOLDS: On what basis should the  
21 regulation of the online, such online travel agencies  
22 be based?

23 MR. TRACAS: I think it would be easy to  
24 construct guidelines for differentiating purely  
25 airline-owned Internet sites that are clearly there to

1 sell one particular product versus broad-based  
2 distribution opportunities that offer numerous  
3 airlines, numerous hotel and car vendors, very similar  
4 to CRSs.

5           When we look back 10 years ago virtually all  
6 bookings were made by travel agents through CRSs.  
7 While consumers were assisted by travel agents,  
8 consumers were presented with all available options  
9 since the CRSs cannot bias or displace. With the  
10 advent of the Internet as an alternative to the travel  
11 agent outlets and with the rise in marketing  
12 relationships between airlines and these online  
13 distribution Web sites, this obviously is not the  
14 situation today.

15           Consumers are no longer presented with all  
16 available options since they are faced with several  
17 layers of Internet bias which masks the neutral CRS  
18 displays. In effect, the Internet distribution  
19 channels have at the very least become equally as  
20 important as the CRSs as a pricing and scheduling  
21 resource and the final distribution outlet to the  
22 consumers.

23           As these Internet distribution channels  
24 function and behave like a CRS, it is more important  
25 than ever that they be governed by the same CRS rule

1 displace.

2           MR. REYNOLDS: But aren't the online systems  
3 fundamentally different in that a consumer can easily  
4 switch through many different channels with relative  
5 ease as compared to the claim that the travel agents  
6 will tend to use one CRS, and are sort of bound to  
7 that one system, at least those who claim that?

8           MR. TRACAS: I think the expectations of the  
9 marketplace has been pretty much been set by these  
10 rulings and traditional buying powers through the  
11 travel agent, that they are fair, that they are  
12 unbiased, and that perception in the marketplace  
13 extends onto the Internet. As consumers go online  
14 they are expecting the same protections they have been  
15 receiving from the travel agency community. Rightly  
16 or wrongly, that's the expectations in the  
17 marketplace.

18           MR. REYNOLDS: So if the online -- so you  
19 don't think the marketplace will discipline those  
20 online agents that bias their displays, that consumers  
21 won't be able to figure out which ones are not giving  
22 them the best information or the neutral information?

23           MR. TRACAS: I don't think it will be. I  
24 think these rules are put in place for professional  
25 travel agents, to protect the consumer with

1 professional travel agent as a seller of the product.

2 Now this is a consumer direct product that no longer  
3 even has a travel agency that obviously is  
4 knowledgeable in this industry to make the buying  
5 decisions.

6 Moving onto the second issue, the comments  
7 demonstrate that there is a substantial objection to  
8 the Department's proposal to eliminate the mandatory  
9 participation rule and the rule prohibiting  
10 discriminatory booking fees, which I will refer to as  
11 MPR and the rule on fees.

12 For years the airlines have complained that  
13 the Department must do something with respect to  
14 booking fees. The problem generally is that there is  
15 no genuine competition within the CRS industry and  
16 therefore the CRS remains free to raise booking fees  
17 year after year without any regard to cost or  
18 competition.

19 USAirways believes that the Department's  
20 current proposal to eliminate the MPR and the rule on  
21 fees was to address this issue of super competitive  
22 booking fees. While we applaud you for this effort,  
23 the proposed remedy would have a grave unintended  
24 consequences for USAirways and other similarly  
25 situated carriers, including virtually all small

1 carriers.

2           The concern is obvious. Adopting these two  
3 proposed rules would greatly favor the larger carriers  
4 and their alleged CRS and Internet distribution  
5 channels. USAirways and the remaining carriers would  
6 rather suffer through the status quo than see the  
7 Department effectively choose winners and losers.

8           MR. REYNOLDS: How do you respond though to  
9 the claims that booking fees are not excessive, at  
10 least on one point, because there have been increases  
11 in CRS functionality and the number of inquiries per  
12 booking have gone up as well, both of which have  
13 increased the costs in the fees?

14           MR. TRACAS: In an industry that has lost  
15 great amount of monies, and as been stated here before  
16 with the airlines that have lost huge amounts of  
17 money, the CRSs are still garnering very profitable  
18 entities. We were getting increases of four to eight  
19 percent a year on our GDS fees that we have no control  
20 over, that we have no say in, that are just  
21 implemented against their bottom line.

22           To conclude, we would ask the Department to  
23 consider these two issues, and the remaining questions  
24 we raised earlier. Would the proposed rule be harmful  
25 or beneficial to the consumers' interest? We submit

1 the strengthening and extending the display rule bias  
2 would clearly benefit the consumer. We further submit  
3 that eliminating the MPR and the rules on fees would  
4 be harmful.

5 Thank you.

6 MR. REYNOLDS: All right, thank you very  
7 much.

8 Next, Northwest Airlines.

9 MR. DENVIR: Good afternoon. My name is Jim  
10 Denvir. I am a partner with the law firm of Boies,  
11 Schiller & Flexner, and Northwest was kind enough or  
12 perhaps foolish enough to ask me to appear today  
13 before you to express its views.

14 I intend to be very brief. It's not as if I  
15 had much choice in the matter, but I may even be able  
16 to beat the clock. I have five points I want to  
17 cover, and I will cover them as quickly as I can.

18 The first is that we strongly believe that  
19 the time for deregulation of the CRS business has  
20 come. The very basis for regulation has all but  
21 disappeared, and with the divestiture of WORLDSPAN it  
22 will virtually completely disappear.

23 MR. REYNOLDS: When is that supposed to  
24 occur?

25 MR. DENVIR: I'm not sure.

1 MR. REYNOLDS: Is there a time set for that?

2 MR. DENVIR: I really don't have the date in  
3 mind. It's some time in the relatively near future.

4 Given those developments, the existing  
5 regulatory regime is no longer factually economically  
6 or legally sustainable. Another way to put it is that  
7 all of the original underpinnings of that rule have  
8 now been knocked out, and in our view the existing  
9 regulatory regime is no longer legally defensible.

10 MR. REYNOLDS: Some have raised the concern  
11 that with regard to the owners of WORLDSPAN that  
12 despite a sale of equity there will still be perhaps  
13 other relationships, contractual or otherwise, that  
14 will make the CRS beholden to it and not much of a  
15 difference in terms of the control aspect.

16 How do you respond to that?

17 MR. DENVIR: Well, let me state first that I  
18 have not heard anything that suggests to me remotely  
19 that the divestiture of WORLDSPAN would be anything  
20 but a complete divestiture of equity interests. Put  
21 that concern aside.

22 Second, I don't know what, if any,  
23 arrangements will follow on that divestiture. It's  
24 quite possible that there will be marketing  
25 arrangements of the sort that American has with Sabre

1 and several other carriers have with other CRS  
2 systems. But I think before you jump to having a  
3 concern about that, it's necessary to kind of step  
4 back and think about what are the concerns that lead  
5 us to be worried about vertical relationships.

6           The first concern is that the vertical  
7 relationship can cause one party or the other to act  
8 in a way that would not be in its independent  
9 interest, okay. In a vertical relationship that's  
10 cemented by ownership the owner could obviously cause  
11 in the case of airlines, CRS -- the airlines could  
12 cause the CRS to operate in ways that are contrary to  
13 its own self-interest, and the airline, recognizing  
14 that it will receive a portion of the CRS profits,  
15 depending upon the cost to the airline engaging in  
16 behavior that would not otherwise be in its self-  
17 interest and take account of those profits in making  
18 its decisions. Once the ownership link is severed,  
19 those incentives go away.

20           Now, you take a typical marketing agreement,  
21 and I have never seen one, but I have read American's  
22 comments, American says that they received from Sabre  
23 something on the order of one one-hundredth of a  
24 percent of American's total revenues.

25           Now, if you think back about the original



1 concerns that led to these rules, one concern was that  
2 the CRSs, again acting contrary to what would be their  
3 own independent self-interest, would favor the owner.

4 There is nothing in these marketing agreements, at  
5 least as I know, that has any payment running from the  
6 airline to the CRS that would cause the CRS to behave  
7 in any way other than a way that's perfectly  
8 consistent with its own economic interests. And if  
9 that is true, there is nothing to worry about.

10 MR. REYNOLDS: But in a truly deregulated  
11 market why couldn't the airlines make it worth their  
12 while for the CRSs in certain areas to behave in a way  
13 that would prejudice the competitors of a particular  
14 airline, for example, in a dominant -- in a hub city  
15 where the one carrier tends to dominate, it could use  
16 a variety of means through relationship with the CRS  
17 to bias displays and other forms of, I guess, perhaps  
18 anticompetitive behavior, why couldn't that occur in a  
19 completely deregulated environment?

20 MR. DENVIR: I suppose it's possible to  
21 conjure up any kind of theoretical possibility.

22 MR. REYNOLDS: But didn't the airlines do  
23 this when they were the owners with the CRSs, or do  
24 you not buy into the proposition that that was ever an  
25 issue?

1           MR. DENVIR: Well, let's just assume that  
2 that was the case. There is a very big different  
3 though because the airline got a piece of every dollar  
4 of profit that the CRS owned, the airline had complete  
5 control over the CRS, and therefore the CRS had no say  
6 in whether the airline -- whether what the airline was  
7 asking it to do was in its own best interest or not.

8           Here you have got an arm's length  
9 relationship, and to create those kind of incentives  
10 you've going to have to have payments going back and  
11 forth. We know from looking at kind of traditional  
12 marketing arrangements that those payments are not  
13 large enough to cause anybody to do anything.

14           We don't know of any payments that run from  
15 airlines to CRS systems. In any event, if that were  
16 to occur, the airline would have to engage in a very  
17 difficult calculus, and that is, balancing the payment  
18 I'm making to the CRS system, what is the benefit I  
19 get back from that?

20           And another point here is that as these  
21 ownership relationships continue to dissipate, if  
22 these marketing relationships are so valuable you  
23 would expect to see CRSs competing for these marketing  
24 relationships, and the airlines would have no  
25 incentive to pick their marketing order other than on

1 the merits, and the merits might include better  
2 service, the merits most likely would include an  
3 opportunity to lower booking fees. And if that  
4 occurs, that's a good thing.

5 Now, what we have as we sit here today is a  
6 hypothetical supposition about something that might  
7 happen in the future, and I would submit to you  
8 respectfully that not only is that beyond the  
9 Department's authority under Section 411, but it would  
10 clearly have very great difficulty passing muster  
11 under the Administrative Procedure Act.

12 You simply can't regulate based on  
13 suspicion. If there are problems here, they will  
14 become evidence, and instead of using the shotgun as  
15 somebody mentioned this morning use a rifle,  
16 investigate it.

17 MR. REYNOLDS: But do you --

18 MR. DENVIR: This is the record, there is no  
19 evidence.

20 MR. REYNOLDS: Do you believe just, I guess,  
21 on another fundamental issue to something that you  
22 just said, that the Department has authority to  
23 regulate independent CRSs?

24 MR. DENVIR: You know, we have not addressed  
25 that issue per se. Implicit in our proposal for a

1 transition period is at least an admission, I believe,  
2 that the Department at least has the authority to deal  
3 with its own messes, and in so doing exercise some  
4 authority over the CRSs.

5           Clearly, the concern that you've been  
6 expressing to me has mainly to do with airlines. Part  
7 of that is jurisdiction over airlines, and you know,  
8 it seems to me extend that jurisdiction to contracting  
9 practices with CRSs. It didn't have jurisdictional  
10 CRSs alone.

11           So we think it's time to deregulate, but  
12 there is an important qualification to that, and that  
13 is, while we urge prompt deregulation of the industry  
14 we don't believe that the Department can responsibly  
15 just suddenly abandon the field without dealing with  
16 the effects, the market distorted effects the  
17 regulation has created.

18           If we were operating on a clean slate here,  
19 Northwest would be among the first to argue for  
20 complete and immediate deregulation. Unfortunately,  
21 that's not the case. The law and its intended  
22 consequences has been at work in this industry for now  
23 nearly 20 years. Regulations that were intended to  
24 dissipate CRS market power in many cases have only  
25 served to entrench it.

1           A couple of examples, the antidiscrimination  
2 rules, you've heard a lot about those today, I don't  
3 have much to add to that; the mandatory participation  
4 rule which gets translated in CRS contracts in the  
5 parity clauses; and after 20 years of regulation the  
6 travel agents continue to be locked into long-term  
7 contracts with the CRSs.

8           It's our view that the effects of these 20  
9 years of regulation have become embedded in industry  
10 contracts, in industry relationship and practices, and  
11 they are not going to go away overnight just because  
12 the regulatory regime has ended.

13           So we have proposed four, we think, narrowly  
14 targeted transitional rules which would be sunsetted  
15 after three years, which I will just briefly summarize  
16 because we have detailed these and the proposed  
17 regulations in our comments.

18           The first one is that during the transition  
19 period the Department should prohibit the enforcement  
20 of any CRS contract with a travel agent in the event  
21 that an airline serving a city in which the travel  
22 agent operates no longer participates in the CRS.  
23 That is, from the travel agent point of view the CRS  
24 were to drop, for example, Northwest, the travel agent  
25 contract with the CRS would become terminal at will by

1 the travel agent. Okay?

2           We believe that this transitional rule will  
3 help to reduce travel agents' dependence upon a  
4 particular CRS, which as you have heard today is a key  
5 source of CRS market power and of the one-sided  
6 bargaining relationships between CRSs and airlines.  
7 And while we think this is not going to be a  
8 frictionless process, that there will be practical  
9 impediments to travel agents rapidly switching from  
10 one CRS to another, the threat that there could be a  
11 significant migration is travel agents from one CRS to  
12 another could at least help to even the bargaining  
13 relationships between the airlines and the CRSs. We  
14 would both be in a very similar state of uncertainty.  
15 That's a state that does not exist today.

16           The second recommendation is that during  
17 this three-year transition the Department should  
18 proscribe the use of parity clauses in any CRS  
19 contract. These clauses coupled with a mandatory  
20 participation rule and a ban on discriminatory booking  
21 fees prevent airlines from negotiating with CRSs for  
22 the level of service that best meets their needs. So  
23 we would like you to continue a ban on parity clauses  
24 for at least three years.

25           Third, during the transition period the

1 Department should adopt a rule that bars CRS systems  
2 from tying airline participation in a system to the  
3 airline making available to such systems fares offered  
4 exclusively through particular Internet Web sites.

5           Those Internet Web sites are the best hope  
6 for ultimately the routing and diminishing CRS market  
7 power, and the availability of those fares, marketing  
8 benefits, promotional benefits ought not to be a point  
9 of leverage that can be used by CRSs against airlines,  
10 but ought to be a point of bargaining, and that  
11 bargaining may be possible if we do away with  
12 mandatory participation, if we do away with parity,  
13 and if we do away with the antidiscrimination rules.

14           MR. REYNOLDS: If Northwest divests itself  
15 of WORLDSPAN completely, why the concern with the  
16 mandatory participation?

17           MR. DENVIR: Well, I have heard a suggestion  
18 here that the rules might apply to relationships  
19 between airlines and CRSs that are not tied to  
20 ownership. I just want to be sure that we are  
21 completely free of mandatory participation, completely  
22 free of parity clauses.

23           And the fourth point just has to do with  
24 display bias. I have three minutes left and I'm only  
25 on the second page.

1           We think the fundamental issue that was  
2 addressed by display bias rules has been cured. At  
3 the same time we recognize that travel agents,  
4 consumers and others have relied on screens that are  
5 not biased for 20 years, and we think that they ought  
6 to be given the opportunity over a three-year period  
7 to adjust to this changing environment, so we would  
8 propose that you maintain the current prohibitions on  
9 screen bias for those three years.

10           We think that's the best way to move toward  
11 a forward deregulated environment. It's a middle  
12 course. It rejects the calls of those of both  
13 extremes advocated, the pervasive regulatory regime  
14 that will continue to tie the hands of airlines and  
15 CRSs, or an immediate and absolute deregulation that  
16 moves too far too fast.

17           This is an important point for Northwest and  
18 I want to emphasize it. While we share the hope  
19 expressed in the NPRM and some of the comments that  
20 continuing advances in distribution technology and  
21 methods will eventually erode the bargaining power of  
22 CRSs, we are in fact not at all confident that  
23 deregulation will eliminate CRS market power in the  
24 near future. Despite that, despite the fact that CRSs  
25 will likely to continue to possess that market power,



1 it is our view that regulation cannot be justified as  
2 a policy matter, as a legal matter, as an economic  
3 matter but the existence of market power alone.  
4 Rather as other sectors of the economy, we believe  
5 that the folks should be on either governmental or  
6 private antitrust enforcement to deal with abuses of  
7 market power if and when they occur.

8           Touch just very briefly on this booking fee  
9 issue, and this market power issue. There are two key  
10 facts that put to rest any argument that CRSs no  
11 longer have market power.

12           Number one, as you have heard today,  
13 airlines still need travel agents. Travel agents stay  
14 in the CRSs. There is no effective way for travel  
15 agents to bypass those CRSs, and according to Sabre's  
16 comments even today only 10 percent of travel agent  
17 bookings are made on the web. So the airlines remain  
18 tied to travel agents, and travel agents remain tied  
19 to CRSs.

20           MR. REYNOLDS: Some airlines do not need  
21 agents. Why can't other airlines replicate their  
22 ability to get their product out there?

23           MR. DENVIR: If we were starting today from  
24 ground zero and we chose a Jet Blue model, perhaps we  
25 could do that. We have and operate a very complicated

1 hub and spoke network with maybe dozens of co-share  
2 partners, with thousands, if not hundreds of thousands  
3 of opportunities, and the most efficient way to get  
4 our product on the shelves, that complicated product,  
5 is through the CRSs at this point.

6 MR. REYNOLDS: Thank you very much.

7 MR. DENVIR: Thank you.

8 MR. REYNOLDS: Next we have Southwest  
9 Airlines.

10 MR. KNEISLEY: Good afternoon, Mr. Reynolds,  
11 Mr. Ray, other members of the panel, distinguished  
12 friends and colleagues in the audience, my name is Bob  
13 Kneisley, that's K-N-E-I-S-L-E-Y, associate general  
14 counsel for Southwest Airlines. I want to talk in the  
15 beginning about some general overarching themes here.

16 Number one, why the CRS rules we believe  
17 ought to be maintained; and in fact, number two, why  
18 the regulations ought to apply to all joint airline-  
19 owned distribution systems such as Orbitz.

20 I would also like to talk on briefly the  
21 screen padding issue that no one has mentioned, but I  
22 think is extremely important to the proceedings as  
23 well as the NYDT data issue.

24 But to start at the top, we believe strongly  
25 that the CRS regulations should be maintained

1 notwithstanding any changes that have happened in the  
2 distribution marketplace. Through the course of the  
3 Department's investigations of the subject, and going  
4 back even to the CAB, '84, 1992, 1997, a consistent  
5 theme has been that the CRSs have effectively regional  
6 monopolies. This is a shared monopoly theory, and the  
7 fact that airline ownership has diminished it seems to  
8 me of CRSs has no bearing on the market power of CRSs  
9 because they still have the same effective control  
10 over travel agents and airlines in the regions in  
11 which they have had -- the Department has concluded --  
12 has had market power.

13 MR. REYNOLDS: Mr. Kneisley, if one of the  
14 fundamental reasons for regulating was because they  
15 were owned by airlines and thus being used to  
16 effective airline competition, how can we regulate the  
17 CRSs if they are independent of the airlines?

18 MR. KNEISLEY: Well, I think the Department  
19 had done a good job, Mr. Ray and others, and the  
20 Department's legal staff has done a good job  
21 explaining why the DOT has authority to regulate non-  
22 airline-owned CRSs, and I don't have to explain that.

23 But under 411, I think you have got ample  
24 legal authority and I encourage you to do that.

25 The fact is that the CRS regulations were

1 adopted for good and valid reasons. CRSs have had  
2 market power over the years, there is no question  
3 about that, and there seems to be no convincing  
4 evidence that the market power that CRSs have  
5 traditionally had has declined.

6 MR. REYNOLDS: But since Southwest  
7 participates only in Sabre, why does Southwest have  
8 any interest in how the Department regulates the  
9 systems?

10 MR. KNEISLEY: Well, thanks for asking.

11 (Laughter.)

12 In fact, CRS regulations have an enormous  
13 bearing on airline competition, and competition that  
14 affects Southwest Airlines. Over the years it has  
15 had, and we have given you a number of examples in our  
16 written comments.

17 Today, we are a minority participant in CRS  
18 systems as you know. We participate in Sabre. About  
19 20 percent on the order of 20 percent of our revenue  
20 comes through travel agents, but that's a lot of  
21 money. That's over a billion dollars. And Southwest  
22 Airlines first quarter profits were actually less than  
23 a two percent operating margin. So we've got 20  
24 percent of our revenue coming through travel agents  
25 that dwarfs, it's more than 10 times the profit we

1 made last quarter.

2           We care because it affects our business  
3 dramatically in fact, and I think what's at stake in  
4 this rulemaking, make no mistake, is the ability to  
5 continue -- ability of small airlines to compete  
6 effectively against much larger airlines with much  
7 greater resources.

8           So I think we have standing to state our  
9 views and I think we have a strong interest in the  
10 outcome.

11           One of the disheartening aspects of the  
12 Department's NPRM is the proposal to eliminate the ban  
13 on discriminatory booking fees. This, we think, would  
14 open the door to abuse, the type of abuse that has  
15 happened historically, and we urge the Department not  
16 to forget the lessons of history. We think that this  
17 would accelerate the trend toward the large carriers  
18 with more significant CRS interests to manipulate the  
19 distribute system.

20           It is also, I think, logically inconsistent  
21 in that the Department is proposing to maintain the  
22 ban on CRS display bias at the same time they are  
23 proposing to eliminate the ban on pricing bias. It  
24 seems to me intellectually and as a matter of market  
25 dynamics the two go hand in hand.

1           And I also -- I think the Department  
2 originally came to the right conclusion in the April  
3 2002 draft NPRM where the Department said at the time  
4 "We are willing," I'm quoting now, "to allow  
5 discriminatory booking fees, imposing high fees on  
6 some airlines but not others would of course destroy  
7 airline competition."

8           I agree completely, and unfortunately that  
9 sentence was excised in the November NPRM that came  
10 out after it went to OMB in fact. So I encourage the  
11 Department to do what it wanted to do, and maintain  
12 the ban on discriminatory booking fees.

13           MR. REYNOLDS: As a general matter, why  
14 would the enforcement process be an adequate way of  
15 dealing with competitive abuses, especially if none of  
16 the systems are airline owned?

17           MR. KNEISLEY: Oh, I mean nobody believes in  
18 this audience, I think, that you can have an effective  
19 enforcement process. The difficulty of gathering  
20 evidence, the DOT, as you well know, as extremely  
21 limited enforcement resources, and notwithstanding the  
22 skill of the people involved you just don't have the  
23 manpower to do it, to effectively monitor and oversee  
24 this massive industry. So I think it's just  
25 impractical.

1           I want to turn for a moment about joint  
2 airline-owned distribution systems. One of our other  
3 problems with the NPRM is that it would create a  
4 bizarre regulatory dichotomy where the legacy CRSs are  
5 subject, continue to be subject to regulations albeit  
6 we think they should be strengthened. But Orbitz,  
7 which is entirely airline-owned, would remain  
8 effectively free of regulation, and we think this is  
9 backwards.

10           The airline owners of Orbitz -- we call them  
11 CADNU -- Continental, American, Delta, Northwest,  
12 United, although somebody else had a better one, I  
13 think it was called DUNCA. But in any event we all  
14 know what Orbitz is. Orbitz is CADNU. They are one  
15 and the same. These are the same airlines that  
16 created CRSs, engaged in the competitive abuses that  
17 the DOT and the CAB well documented, so that we have  
18 that long history, and it seems to me that in any  
19 principal approach to the regulation of distribution  
20 you must give exceptional scrutiny to collective  
21 airline-owned distribution systems.

22           And our position is that any distribution  
23 venture that is collectively owned or controlled by a  
24 consortium of airlines and that purports to offer an  
25 integrated display of fares and services to the public

1 or travel agents should be subject to the Department's  
2 rules against anticompetitive behavior.

3 MR. REYNOLDS: But if market power is one of  
4 the reasons or bases upon which the -- justifying the  
5 rules of the CRSs, where is the market power in the  
6 case of Orbitz?

7 MR. KNEISLEY: Well, I think -- look at the  
8 market share data that's out there for one thing.  
9 Look at how many airlines participate in Orbitz. I  
10 think it's become effectively an indispensable to  
11 airlines in the online sector. I think that, coupled  
12 with the airline ownership, gives you ample grounds to  
13 regulate it very closely.

14 I want to turn for a minute to the screen  
15 clutter issue because nobody has touched on that. As  
16 I think everybody in the room knows, since the DOT  
17 last revisited its CRS rules, home sharing has  
18 proliferated enormously, and as a result duplicative  
19 CRS displays have also proliferated.

20 The consequence of this is an enormous  
21 amount of clutter on CRS screens with fictitious  
22 listings that make it appear as though those co-  
23 sharing carriers offer twice as many flights as they  
24 actually offer. We, frankly, this is a fraud on the  
25 public and ought to be stopped.



1 I have passed out to you as just a copy of  
2 an attachment of our comments filed last month where  
3 we checked CRS -- the Sabre screen, because that's the  
4 system we're in, for the Indianapolis/San Diego  
5 market, and you know, this could be any market, but it  
6 just happens to be one that illustrates the point.

7 And what we found is that, of course, this  
8 is all connecting service there, what we found is that  
9 because of the fictitious listing of three co-shares,  
10 two of them, Northwest/Continental, and one a  
11 United/USAirways co-share, Southwest Superior  
12 connection in this market is pushed to the bottom of  
13 the fourth screen. You will see it if you keep going.

14 Now, the problem is this is going to get  
15 worse because as soon as the  
16 Delta/Northwest/Continental alliance implements full  
17 co-sharing we presumably would include similar screen  
18 padding, and at that point you would have an eight  
19 additional fictitious listings for a total of 11, and  
20 the problem is the DOT's -- the NPRM recognizes that  
21 this is a problem, but it doesn't do anything about  
22 it, with respect I say that.

23 (Laughter.)

24 The NPRM proposes to limit the number of  
25 connections that may be listed in the co-share

1 arrangement, I think up to two. The problem is it  
2 doesn't do anything effectively. What I just -- the  
3 example I just gave you would prohibit none of those  
4 connections from being listed, so I would respectfully  
5 say it's an ineffective remedy.

6 I also have attached a copy of a terrific  
7 article by Terry Trippler that shows how an AirTran  
8 connection would be between -- this is between  
9 Minneapolis and Gulfport/Biloxi, Mississippi -- would  
10 be totally buried among 40, so-called 40 connections,  
11 28 of which are entirely duplicative and fictitious.

12 Now, how does this advance the consumers'  
13 interest? This is something where -- this just  
14 happened because co-share has happened, and this is a  
15 consequence that no one, I think, has thought through.

16 We have a solution, very simple. One  
17 flight, one listing. It seems to us that this would  
18 restore truthfulness to CRS listings. It would also  
19 avoid the clutter and the padding that distorts  
20 airline competition in the way that I illustrated with  
21 these attachments.

22 MR. REYNOLDS: Would you advocate the same  
23 for international services?

24 MR. KNEISLEY: Well, probably, but we're not  
25 an international carrier, and we haven't opined on

1 that so I would rather demur.

2 Let me just take a minute very briefly to  
3 talk about the MIDT data issue. We don't use MIDT  
4 data. I don't think there is a legitimate competitive  
5 need, I mean a need for carriers to have this, and we  
6 think there ought to be an opt-out provision as the  
7 DOT has proposed, and we endorse that fully.

8 But before I get the hook, there is one  
9 other issue, and that is, the rules on third-party  
10 access to travel agents really need to be  
11 strengthened. Part of the problem is there is no  
12 today effective third-party access by airlines such as  
13 Southwest outside of CRSs to travel agents.

14 We know that the Department in 1992 tried to  
15 foster this, and we're disappointed because it just  
16 turned out that it -- it didn't work, it hasn't worked  
17 for Southwest Airlines, but we have given some  
18 examples in the written comments on how to do that.

19 Thank you.

20 MR. REYNOLDS: Thank you very much.

21 Next, Shepherd Systems.

22 MR. MALIK: Mr. Chairman, gentlemen, my name  
23 is Mike Malik. I am the president and chief executive  
24 officer of Shepherd Systems. That's M-A-L-I-K.

25 Shepherd Systems principal line of business

1 is the development and provision of web-based business  
2 intelligence tools built on MIDT. Shepherd's customer  
3 list includes large and small airlines from all over  
4 the world. The company also serves a global travel  
5 agency with marked intelligence and systems and  
6 services. And given the nature of Shepherd's business  
7 model, we give very close consideration to the NPRM,  
8 particularly those sections that deal with MIDT. So  
9 what I'm going to do is limit myself to respond to  
10 Part 255.10.

11 In essence, what we believe is that the  
12 proposed rules should not be implemented as they are  
13 written. I will demonstrate that information upon  
14 which the Department relied in developing the proposed  
15 MIDT rule is incomplete, and as such will not have the  
16 desired effect.

17 It will likely result in less competition  
18 and even less efficiency in the airline business,  
19 ultimately harming the consumers who use the services.

20 The marketplace has indeed changed  
21 significantly since the original comments were  
22 submitted on the docket. Once the Department fully  
23 examines the current environment I am confident that  
24 it will conclude the proposed rules as set forth in  
25 the NPRM as they pertain to MIDT should not be

1 implemented.

2           Now, as a way of background, the  
3 Department's stated goal set forth in Section H-9 of  
4 the NPRM are as follows: To allow the systems to sell  
5 as much data as possible while minimizing the  
6 potential harm to airline competition and to enable  
7 travel agencies to protect proprietary business data.

8           With regards to possible harm to airline  
9 competition, the Department seems to be principally  
10 concerned that detailed MIDT data may be used by hub-  
11 dominant airlines to keep new entrant low-fare  
12 carriers out of their hubs.

13           Secondly, there is further concern that  
14 travel agencies may be at a disadvantage when  
15 negotiating performance-based contracts with airlines.  
16 This concern arises because originally only airlines  
17 and then only the larger ones had access to the  
18 necessary MIDT data for evaluating such performance.

19           And to achieve these goals the Department is  
20 proposing restrictions on the type of data sold to  
21 airlines. The two major proposals set forth by the  
22 Department are: number one, a ban on the release of  
23 data on bookings made by individual travel agencies;  
24 and number two, a ban on the release of data on  
25 bookings for airlines that have not consented to the

1 release of data on their bookings.

2           The Department does however recognize a  
3 number of legitimate uses for MIDT data. Generally  
4 speaking, these uses would appear to fall in the areas  
5 of network planning, marketing, revenue management and  
6 pricing, particularly in the non-U.S. domestic arena.

7           I would like to highlight five points which  
8 are extremely pertinent.

9           Number one, open access to booking data is  
10 crucial to the competitive process and the overall  
11 efficiency of the airline industry.

12           Now, the availability of data served U.S.  
13 industry very well, most notably since deregulation of  
14 1978, and as the Department noted in the Federal  
15 Register, competition usually benefits when  
16 competitors have more access to information. In this  
17 respect there are numerous databases and means of  
18 assessing the market position and sales of carriers  
19 and agencies. Therefore, masking data for travel  
20 agencies or providing opt-out provisions for carriers  
21 does nothing to restrict data; it only creates a bias  
22 against MIDT, a database that carriers and others have  
23 invested large sums of money to better optimize their  
24 route network and pricing capabilities and therefore  
25 lower their costs and pricing to the consumer.

1 Point number two, there is no substantial or  
2 factual body of evidence or data that suggests that  
3 regulation of MIDT data is indeed required to protect  
4 travel agencies or smaller carriers.

5 And supporting these rules the NPRM relies  
6 on anecdotal information rather than documented  
7 evidence. For example, the Department states:  
8 "Officials from Legend, the start-up airline based in  
9 Dallas's Love Field, informed the staff that American  
10 was able to use the data to target agencies selling  
11 tickets on Legend, and thereby undermining Legend's  
12 ability to obtain travel agency bookings."

13 The Department did not present any factual  
14 evidence to support this anecdotal claim. Most  
15 industry analysts believe that Legend went out of  
16 business because of a faulty business plan and a lack  
17 of adequate capital, not because how data was used  
18 against the airline.

19 Secondly, if there was some illegality  
20 involved in actual facts of the case, then they should  
21 have been pursued through existing legal and  
22 regulatory means.

23 Thirdly, if these statements of Legend are  
24 intended to portray how a smaller carrier is  
25 disadvantaged versus a larger legacy network carrier

1 because of the adverse use of MIDT data, then should  
2 the Department not ask the question, why are smaller,  
3 low-fare carriers producing substantially better  
4 margins than the major network carriers despite this  
5 obstacle?

6 I would also note --

7 MR. REYNOLDS: Excuse me. Couldn't it be  
8 said that they would be enjoying even larger profit  
9 margins if that were indeed happening? I mean, is  
10 that truly --

11 MR. MALIK: That's another way of looking at  
12 it, yes.

13 (Laughter.)

14 It would also be noted in the comment of the  
15 National Business Travel Association in this document  
16 the NBTA believes that the biggest threat to price  
17 competition and data privacy is an attempt by some  
18 carriers to obtain detailed ticket data on corporation  
19 and travel agency.

20 Well, I would like to point out that MIDT is  
21 not ticket data and does not contain personal or  
22 financial information on the individual travelers. I  
23 want to repeat that because it is an important point .  
24 MIDT does not contain personal or financial  
25 information on the individual traveler, which takes me



1 to my third point.

2           Based on the submitted comments in the NPRM  
3 the travel agency community is either uninterested or  
4 divided on the Department's proposal to mask agency  
5 level data. We have reviewed all the comments by  
6 travel agencies and travel agent organizations, and  
7 interestingly, the vast majority of travel agents that  
8 submitted comments, and the list is quite extensive,  
9 did not recognize MIDT as an issue

10           Twenty-seven individual filings by travel  
11 agency and travel agency organizations failed to  
12 mention MIDT.

13           Point four, MIDT is becoming increasingly  
14 and more widely available and affordable. There are  
15 various products available that permit smaller  
16 carriers and travel agents to purchase and utilize  
17 customized reports on systems to allow them to manage  
18 their businesses more effectively and efficiently.

19           Today, Shepherd is running pilot programs  
20 with agencies all over the world, in the U.S., the  
21 United Kingdom, Australia, Portugal and Canada.  
22 Agency companies have now begun using MIDT-based  
23 systems on a full-time basis.

24           And as both agencies and airlines now have  
25 access to increasingly transparent marketing data, the

1 commercial discussions can be conducted on a more  
2 relevant basis with the inevitable benefits to airline  
3 traveling consumers.

4           I will give worldwide examples in this  
5 because our business is worldwide. Smaller carriers  
6 such as Quitar Airways are using MIDT-based systems  
7 today, and according to the chief executive of Quitar,  
8 "When we first started using Shepherd Systems three  
9 years ago, we were cautious about the usefulness of  
10 investing in MIDT data, but the results have shown  
11 that MIDT is the best source of marketing and  
12 competitive insight, and Shepherd technologies is  
13 invaluable in providing us with the intelligence we  
14 need to make fact-based timely decisions for our  
15 business."

16           And according to Mr. Mike Bond, executive  
17 manager of strategy and planning at South African  
18 Airways, "Although we have been using MIDT for a  
19 number of years, due to financial challenges in the  
20 industry and our efforts to cut cost we did our own  
21 analysis and found that MIDT is something that we  
22 cannot live without."

23           In its comments filed in the docket, the  
24 Association of Asia Pacific Airlines fully supported  
25 maintaining the current rules in their current form,

1 and wish to see no limitations placed on the  
2 transparency or integrity of the data.

3           The majority of the 17 members of this  
4 organization cannot be characterized as large  
5 carriers. The Carrier Association of America has  
6 expressed concern with the availability with the use  
7 of MIDT. However, some of its members have been users  
8 of MIDT-based systems.

9           It must be clear even to the casual industry  
10 observer that the traditional users of MIDT are having  
11 substantially harder time to the new economic  
12 realities, adjusting to the new economic realities of  
13 the airline world than the smaller, more nimble  
14 counterparts.

15           In summary, product derivatives of MIDT and  
16 information systems and underlying databases are  
17 affordable to the travel agencies and smaller  
18 carriers.

19           My last point is that air carriers believes  
20 that MIDT data is critical to their planning and sales  
21 administration efficiency as has already been informed  
22 to you today.

23           The U.S.A. carrier industry has lost roughly  
24 \$21 billion since 2001. There is excess capacity, a  
25 loss of pricing power, strenuous competition from low-

1 fare carriers. Major concessions are being sought  
2 from employees, aircraft leasers, and creditors in an  
3 effort to either avoid or emerge from Chapter 11  
4 bankruptcy . In this environment it behooves the  
5 Department to avoid inhibiting the ability of air  
6 carriers to optimize their network planning and sales  
7 and marketing activities.

8           So in conclusion, MIDT is widely available  
9 to all constituents who wish to use it. There is a  
10 wide array of software tools commercially available to  
11 fit all budgets. Open access to industry data  
12 promotes a healthy, competitive environment whereas  
13 masking or hiding data is detrimental to the free  
14 market economy.

15           Moreover, if there is predation or  
16 anticompetitive behavior in the marketplace, then the  
17 justice Department can utilize the antitrust laws, or  
18 the Department can utilize enforcement authority to  
19 deal with these anticompetitive practices.

20           Adoption of the proposed changes would not  
21 advance the causes of greater market transparency.  
22 Indeed, it will serve to make effective market-driven  
23 decisions more difficult an efficient, the cost of  
24 which will be ultimately borne by the consumer.

25           Further, if regulation of MIDT were adopted,

1 then inevitably the Department will have to consider  
2 adopting similarly restrictive explicit regulatory  
3 position on all other existing and future marketing  
4 databases affecting travel. This would, of course,  
5 include any ticketing-based marketing data offered by  
6 industry settlement providers, frequent flyer  
7 databases and data shared amongst airline alliance  
8 members, marketing data made available through credit  
9 card companies based on purchase data, and the  
10 Department's own travel marketing data, et cetera.  
11 The list goes on and on.

12           If similarly regulatory constraints are not  
13 explicitly placed on all these other sources of  
14 marketing data, then it is likely that whatever  
15 benefit the Department was seeking in constraining  
16 MIDT would not be achieved as airlines would migrate  
17 towards these other marketing databases.

18           Mr. Chairman, ladies and gentlemen, for the  
19 reasons set forth above, I ask you that the proposed  
20 regulations not be enacted, and I thank you for your  
21 time.

22           MR. REYNOLDS: If I may, with respect to the  
23 proposal on excluding data that identifies individual  
24 subscribers, travel agents, how important is that?  
25 How big a piece of the data that you deal with and

1 provide to airlines? I mean, can you give me some  
2 perspective on that?

3 MR. MALIK: The data is used basically to  
4 manage performance relationships between the travel  
5 agencies and the airlines, without which there would  
6 be no basis on which these performance relations could  
7 be based. So that is the basis on which business is  
8 done right now.

9 MR. REYNOLDS: But is the bulk of your  
10 business though in terms of monitoring the larger  
11 interactions of carriers rather than the focus on  
12 carriers' concerns with individual travel agents? Do  
13 you follow me?

14 MR. MALIK: We provide the systems and  
15 services for them to monitor those performances, so  
16 yes, a majority of our business is focused towards  
17 that, but we also do work on network planning and  
18 scheduling, et cetera, as with all vendors in our  
19 area.

20 MR. REYNOLDS: I know that other -- in  
21 written comments others have contended that there is a  
22 First Amendment argument against the proposed  
23 regulation. Do you have any comment or thought on  
24 that?

25 MR. MALIK: I have no comment unless my

1 counsel has.

2 MR. REYNOLDS: All right. Well, thank you  
3 very much.

4 MR. MALIK: Thank you.

5 MR. REYNOLDS: Next the Air Carrier  
6 Association.

7 MR. FABERMAN: Thank you, Mr. Chairman,  
8 members of the panel. My name is Ed Faberman,  
9 Executive Director of the Air Carrier Association of  
10 America, and I am not going to be apologetic about  
11 representing carriers that are making money, and I do,  
12 I mean I really feel sorry for all those poor carriers  
13 that are not, and have been in bankruptcy.

14 However, I guess we are tired of hearing  
15 that because they have lost money or they have been in  
16 bankruptcy that therefore anything they want, whether  
17 it be alliances, whether it be keeping airports closed  
18 to competition should be given to them.

19 On February 13th, the Department issued its  
20 latest regulatory document proposing to amend rules  
21 governing CRS systems. It's now been approximately  
22 2400 days since the Department began this long  
23 journey. We are hoping that this is going to bring it  
24 to an end and that we will soon see some final  
25 regulations.

1           That NPRM and others have acknowledged that  
2 the record already amassed in this proceeding is  
3 detailed, lengthy, complex. Therefore, we believe  
4 it's time to issue some final regulations, and we  
5 suggest that it's not time to do away with the  
6 regulations. It's time to make them efficient and  
7 make them real, and to promote competition. We are  
8 not just dealing with CRS issues; we are dealing with  
9 airline competition, we are dealing with travel and  
10 transportation in the future.

11           In this same period of time the Department  
12 has taken a number of steps to strengthen the nation's  
13 largest carriers that already dominate most airports.  
14 The Department has approved extensive marketing  
15 alliances, two of them in fact that allow those five  
16 carriers to control about 60 percent of the U.S.  
17 market; that certain airports, the numbers are  
18 staggering.

19           For example, in Cincinnati, the Continental,  
20 Delta, Northwest Alliance controls about 96 percent of  
21 the market. In Charlotte, United, USAirways controls  
22 about 92 percent of the market, and it goes on and on  
23 and on.

24           CRS tapes made available under Section  
25 255.10 provide detailed booking data for dates of



1 travel, including carriers, booking class, flight,  
2 time of flight, date of travel, routings, point of  
3 origin, et cetera, et cetera. It discloses  
4 significant information about travel agencies, about  
5 corporations, about who -- you know, which groups are  
6 selling tickets and which ones are not.

7           The data that you can get under this  
8 regulation identifies and quantifies support or lack  
9 thereof in a particular market by travel agencies and  
10 corporations.

11           So just think about that for a second. So  
12 in a market where you control 90 percent of the --  
13 already control 90 percent of the market, and you're  
14 used to getting 100 percent from certain corporations  
15 or travel agencies, you immediately know when one of  
16 them dares to sell any bit of travel on a competitor,  
17 particularly a new entrant.

18           MR. REYNOLDS: Mr. Faberman, as you may have  
19 heard, a lot of folks have said that there is no  
20 evidence or data to support the misuse of such data,  
21 the MIDT. Do you have any evidence? Is there any  
22 evidence that you have that it has been misused in any  
23 way?

24           MR. FABERMAN: Well, I would suggest to you  
25 that it can't be properly used in any way, so I would

1 suggest that any use of the data concerning who a  
2 corporation is selling to or buying from, or who a  
3 travel agency is selling through is misused  
4 information.

5           Certainly there is example after example of  
6 what happens when a new entrant tries to come into a  
7 market that is already dominated by incumbent  
8 carriers, and those examples show that the incumbent  
9 carriers quickly respond to travel agencies and  
10 corporations the minute that some ticketing tends to  
11 go against them.

12           Now, are those corporations and travel  
13 agencies prepared to submit affidavits and statements  
14 to the Department? No. However, there is plenty of  
15 statements made by travel agency representatives, by  
16 representatives of corporate sales, corporate travel  
17 Departments that highlight the fact that this occurs  
18 and it occurs on a regular basis.

19           MR. REYNOLDS: In arguing that the MIDT  
20 proposed rule is bad, at least one airline claims that  
21 there is no poaching of already booked passengers, and  
22 if there is lawsuits and enforcement actions are the  
23 appropriate responses.

24           What is your response to those claims?

25           MR. FABERMAN: Well, I won't deny the fact

1 that there is probably a limited amount of poaching  
2 going on. However, it's not the poaching that's the  
3 issue. It's the fact that the large carriers knows  
4 that corporation ABC is now using one of their  
5 competitors, and that large carrier then goes to that  
6 corporation, and suggests to them that some of the  
7 deals they may be getting on international flights,  
8 some of the other bargains they may be getting will no  
9 longer be there. So it's future sales that are  
10 impacted, not the existing sales.

11 And as far as enforcement actions goes, I  
12 will emphasize what Bob Kneisley from Southwest said,  
13 and that it would be a mammoth effort for the  
14 Department to get involved in an enforcement action  
15 involving this type of issue. The Department has not  
16 been involved in too many enforcement actions in the  
17 past, and this would take a heroic amount of work, and  
18 even Tom Ray could not complete that in a reasonable  
19 amount of time.

20 MR. REYNOLDS: Well, just to keep following  
21 up on this point. In written comments one airline  
22 points to the success of AirTran and Frontier in  
23 operating out of two of the hubs of two of the largest  
24 carriers as evidence that MIDT data and override  
25 agreements could not have been used, at least

1 successfully, to forestall competitive challenges at  
2 dominated hubs.

3                   What is your response to that contention?

4                   MR. FABERMAN: Well, that's just a false  
5 statement. I mean, the fact of life is that a number  
6 of low-fare carriers, including the ones you  
7 mentioned, have gone into some smaller markets and  
8 have not been able to stay in those small markets for  
9 a variety of reasons. I will not suggest that the  
10 only reason you can't stay in a market is because of  
11 the use of the MIDT data, but certainly you go into --  
12 let's say you're going to fly from Atlanta or Denver  
13 to someone else's hub, and all of a sudden you are in  
14 that other hub, and that hub airline all of a sudden  
15 sees your presence and you have two flights a day or  
16 three flights a day compared to their 15 flights a  
17 day, and all the sudden they were getting 100 percent  
18 of sales from corporation ABC, and beginning the  
19 following week they are getting only 90 percent, 95  
20 percent of those sales.

21                   It's pretty obvious where those other  
22 tickets are going to, and it's pretty obvious how that  
23 incumbent carrier can then come down pretty hard on  
24 that corporation because the new entrant is only going  
25 to take people to a couple of markets at most while

1 the incumbents can fly them all around the world,  
2 particularly with alliances.

3           In the November NPRM, the Department  
4 acknowledged that Delta thus can see, for example, how  
5 many passengers are being booked by each Atlanta  
6 travel agency on each flight operated by its rival.  
7 And then it mentions comments that Midwest Express has  
8 submitted. So yes, complaints have been submitted as  
9 has ASTA and NBTA.

10           Another earlier docket DOT said an incumbent  
11 airline can learn from the CRS the fares being charged  
12 by a new rival, and can plan its response. The  
13 Department of Justice has said that carriers are still  
14 able from CRS to identify corporations and travel  
15 agencies where they are losing business, and using the  
16 competitor that is gaining business at their expense.  
17 Carriers does have the ability to identify and  
18 retaliate against competitors, reducing even off-  
19 tariff fares.

20           Minnesota state attorney general Mike Hatch  
21 has made a number of similar comments in his  
22 investigation of things that have gone on in the State  
23 of Minnesota.

24           American Express, I think, has said it best  
25 when they talk about this data and they say what began

1 as a tool to promote competition has become a weapon  
2 to eliminate it. MBTA and again AAA have all  
3 submitted comments. Let me just highlight some of the  
4 comments that some of those who are saying that, oh,  
5 this is not an issue; there is no problem out there --  
6 I mentioned comments that Shepherds has made. They  
7 claim that MIDT data permit an airline to properly  
8 evaluate market size and potential and to recognize  
9 and project developing demand fronts, that MIDT data  
10 will help the airline's sales force identify those  
11 agencies that can benefit most from having capacity  
12 and optimum pricing.

13           There is ample evidence of the success of  
14 low-fare segment of the airline industry, and low fare  
15 carriers out-carry every major network carrier at  
16 cities they serve in common. These statements are not  
17 based on fact at all. The fact that low-fare carriers  
18 have succeeded or are doing better again is not the  
19 cause -- it's not because of MIDT data or the fact  
20 that that data may be eliminated or not eliminated.  
21 It has to do with many, many other things that these  
22 large carriers continue to do.

23           In fact, I would suggest that if you block  
24 another way for a large carrier to attack small  
25 carriers, then maybe they'll focus on their strengths

1 and stop wasting money on losses.

2           Let me also mention Delta Airlines'  
3 comments. And, you know, from the statements and  
4 comments made by Delta, I think we have to feel sorry  
5 for all of Delta's people, I guess, except for their  
6 senior people, I guess, who have ended up making lots  
7 of money. Delta suggests that some routes would  
8 receive more than an optimal amount of service,  
9 resulting in empty claims and greater losses to  
10 carriers. New entry carriers are the only ones that  
11 are going to be able to grow and operate profitably.

12           Now Delta has started a new low-fare  
13 carrier. Delta has thrown all kinds of flights into  
14 the West Coast because of service by Jet Blue and Air  
15 Tran. I guess it's because they use the MIDT data to  
16 recognize new markets where they can grow and  
17 flourish. I doubt it. They're using the MIDT data so  
18 that they can identify who is flying on their low-fare  
19 competitors.

20           Delta had an interesting ad in Atlanta --  
21 they've run it a number of times -- in which they go,  
22 drop off dry cleaning, pick up dry cleaning, give  
23 presentation in New York City in between. Don't let  
24 another airline's schedule decide your schedule. And  
25 they say, well, they got 36 flights a day to New York

1 City and 30 flights a day to D.C. and so forth. And  
2 that doesn't even include their alliance partners.

3           You have 36 flights a day to New York City,  
4 your competitor has six, and you need MIDT data to  
5 decide which travel agencies you should focus on to  
6 better sell your seats and better figure out what your  
7 prices should be? That's nonsensical, and we all know  
8 that.

9           MR. REYNOLDS: But don't the -- I mean, at  
10 least one carrier asserts that the data gives it a  
11 better picture of its large network competitors rather  
12 than smaller carriers, especially because the latter  
13 rely heavily on direct bookings, which are not  
14 included in MIDT, and thus may raise the question why  
15 do the smaller carriers and new entrants need to be so  
16 concerned about the use of the data if it is indeed so  
17 flawed with respect to their activities?

18           MR. FABERMAN: Well, first of all, under the  
19 Department's proposal, which we endorse, is that any  
20 carrier should be able to opt out. So assuming that  
21 all the large carriers decide to stay in -- and  
22 certainly internationally, everybody can stay in --  
23 then they don't need the data on the small carriers.

24           But the key point is that when you're flying  
25 hub to hub competition against another larger carrier,



1 you both have 10 flights, you know, you're both in a  
2 similar position. You have 18 flights a day in a  
3 market, and a new entrant comes in with two or three,  
4 you can immediately identify, immediately identify who  
5 is buying tickets on your competitor's three flights a  
6 day.

7           And remember, it is one of the three or four  
8 items that determine your ability to survive in this  
9 industry. You know, they have the frequency. They  
10 have the gates and facilities. They have everything  
11 going on with that hub. It's the Department's  
12 responsibility and the government's responsibility to  
13 promote competition even in dominated hubs. And this  
14 is why this data is nonsensical. And we've heard  
15 claims this morning already before that, well, the hub  
16 issue isn't -- we don't need the data in hubs. It's  
17 not the hubs where Delta claims they need it. They  
18 claim they need it to go in other markets. Well,  
19 fine. Then just eliminate new entrant competitors,  
20 and they can opt out.

21           Again, in markets where a large competitor  
22 such as Delta and Continental might have 20 or 30  
23 flights, and a small competitor might have four, they  
24 don't need MIDT to have data. Its only purpose -- and  
25 I have not heard evidence of one legitimate use of it.

1 We asked you quickly to address it. We also tell you  
2 that the multiple listings that were mentioned by  
3 other commenters -- we agree. We agree that that has  
4 to be addressed, too. We would suggest that we would  
5 not object to double listings, but not more than that.  
6 Thank you.

7 MR. REYNOLDS: Thank you very much. I think  
8 at this time we'll take a short break, 10 minutes, and  
9 be back at 2:35.

10 (Whereupon, a short recess was taken.)

11 MR. REYNOLDS: Just a reminder that any  
12 written materials supplied should also be placed in  
13 the docket formally. Thank you. And now we have  
14 Travelocity.

15 MR. QUINN: Good afternoon, Mr. Chairman.  
16 My name is Ken Quinn. I'm a partner at the law firm  
17 of Pillsbury Winthrop, LLC. I'm appearing today on  
18 behalf of our client, Travelocity.com. I'd also just  
19 mention I also happen to be the editor-in-chief of the  
20 Air and Space Lawyer, and we had just come out with an  
21 issue that I'd like to plug which has views of three  
22 -- three different views on the CRS rules by very  
23 distinguished practitioners, some of whom we've heard  
24 from today, and I'd invite everyone's attention to it.  
25 It's very thoughtful.

1           Travelocity, as you know, is the leader and  
2 originator really in online travel distribution to  
3 consumers. Launched in '96, they've won tons of  
4 awards, including the world's leading travel Internet  
5 site. Our first point, and fundamentally, is that the  
6 Department needs to deregulate the entire market for  
7 air travel distribution.

8           We agree with your tentative decision not to  
9 regulate the Internet. We'd just argue that you  
10 didn't go far enough. You need to kill the CRS rules  
11 in their entirety. And we put up here -- I mean, many  
12 think tanks, academics, airlines, other CRSs, consumer  
13 groups, travel agents agree, people as divergent as  
14 United saying eliminate the rules which have become  
15 not only obsolete but actually harmful, and Sabre  
16 agree, and where Qatar says simply allow the rules to  
17 sunset -- but as you know, the airlines fought  
18 deregulation themselves early on. This is about as  
19 close to an industry consensus, I think, on a major  
20 issue as we have seen. And the time is ripe, and I  
21 would urge you to do it as soon as possible.

22           We also emphasize, I think, another point  
23 that first came up this morning, that the whole  
24 transformation of ticket distribution is the driver.  
25 As you can see from the chart, in the '80s, consumers

1 really didn't have a choice. They had to call their  
2 travel agent or they had to call the airline, and they  
3 didn't -- basically, they looked at schedules. They  
4 didn't look at fares. They were given fares in terms  
5 of early time. Airline yield management focused on  
6 maximizing the amount of money per seat.

7           That all was radically transformed with  
8 Travelocity and other online providers now, to the  
9 point where we are today, where there is just multiple  
10 channels of distribution. The consumer has a number  
11 of options today with the Internet. They have  
12 basically doubled their options. You can choose among  
13 four, calls to the airline, airline web sites, brick  
14 and mortar agents, and online travel retailers.

15           We became the first one in '96, as I said,  
16 but it really turned that yield management on its  
17 head. For the first time, instead of figuring out by  
18 schedule how to get from one place to another, you  
19 searched by fares. Travelocity introduced the low-  
20 fare search finder, and then later the multiple  
21 airport, which is great for new entrants, attacking  
22 hub markets. And consumers were empowered to the  
23 point where we now have 82 percent of passengers using  
24 the Internet, and half of them are using it now to  
25 book travel.

1           We just had a Jupiter media announcement  
2 three days ago that 30 percent now of all airline  
3 tickets are literally sold on the Internet.

4           MR. REYNOLDS: Once again, that's by number  
5 of tickets sold?

6           MR. QUINN: I believe that's by number of  
7 tickets. But I'm going to check on that. We had that  
8 point earlier, whether it's by revenue or not. We  
9 didn't do the study; Jupiter did.

10          MR. REYNOLDS: Sure. And then if possible,  
11 just trying to figure out what by revenue is the  
12 percentage of those sold and passengers using the  
13 Internet.

14          MR. QUINN: We'll be happy to get you a  
15 record for that, and we'll submit it to the docket,  
16 Mr. Chairman.

17          MR. REYNOLDS: Thank you.

18          MR. QUINN: But I have to say, in light of  
19 all of this -- just a quick overview of the phenomenon  
20 that we experience ourselves every day. It's just not  
21 credible for my friend Gary Odernhoefer at Orbitz to  
22 suggest that CRSs are a root of evil. The poor  
23 airlines or consumers, as he said, are trapped by CRS.

24          That's nonsense. It ignores the facts.  
25 Southwest, Air Tran, Jet Blue -- they're selling half

1 of all their tickets now over their own web sites.  
2 You heard the numbers earlier this morning. CRS  
3 bypass is dramatic. Once 81 percent of all tickets  
4 went through travel agents, went through CRSs. That  
5 number at Sabre is down to 53 percent. But  
6 Continental just announced 50 days in a row, as of  
7 April 23rd, 3 million or more bookings on their web  
8 site. Huge records.

9 Delta told you this morning -- sorry -- now  
10 less than half of their revenues come from travel  
11 agents than CRSs. This is an enormous bypass of a  
12 major channel of distribution. I'm sorry. I didn't  
13 mean --

14 MR. REYNOLDS: No. But could any of the  
15 major airlines afford to not be included in a CRS at  
16 this point?

17 MR. QUINN: I think it's a set of mutually  
18 assured destruction at this point. A major CRS cannot  
19 afford to not have a major airline in large part, and  
20 a major airline cannot afford to not be participating  
21 in a CRS. But the problem is the economics are skewed  
22 dramatically when a CRS like WORLDSPAN is owned by  
23 airlines because the mutual destruction goes -- you  
24 can harm competition. You can harm competitors by not  
25 only bringing bookings to your CRS, but you can

1 degrade another's system and do competitive harm  
2 there.

3           So that is the reason for the recommendation  
4 by Professor Salop for divestiture plus deregulation.

5           MR. REYNOLDS: So the contention is that the  
6 CRSs at this point do not have market power?

7           MR. QUINN: Absolutely not. The evidence of  
8 market power -- you don't see competitors reducing the  
9 price they put to their product by 12 to 20 percent,  
10 rolling it back and freezing it for three years. If  
11 that doesn't debunk the myth of market power, nothing  
12 does. I was very interested in your NPRM. It said  
13 repeatedly excessive booking fees, super-competitive  
14 booking fees, but then also said, but we make no  
15 finding with respect to this, and for good reason.

16           There is no study, there is no evidence of  
17 super-competitive pricing in this industry. In fact,  
18 we put in a study by E&K that also debunked that myth,  
19 saying that the costs have increased dramatically with  
20 message volume, message complexity, and that the  
21 actual booking fees are reasonable, are cost based,  
22 and they're even less than the airline-owned  
23 WORLDSPAN. And, of course, the telling point, is that  
24 for the most part airlines complain about excessive  
25 booking fees. They go back to the percentage numbers

1 of increases for the last 20 years. Well, who owned  
2 them for the last 20 years? Airlines. So they're  
3 telling people that they were gouging themselves? I  
4 think not.

5 MR. REYNOLDS: Do you believe that in the  
6 past the CRSs had market power?

7 MR. QUINN: I don't know. I know Justice at  
8 one time believed that. I'm not sure that they  
9 believe that today. I think if you asked most serious  
10 economists, asked the FTC, they would believe that  
11 they do not have market power. Again, it gets back to  
12 bargaining leverage. They are major players.  
13 Airlines are major players. But again, evidence in  
14 the real market is reductions in booking fees. Market  
15 power, monopoly market power, is exemplified by  
16 extracting monopoly rents, not reductions in the price  
17 of your product.

18 But again, as to my friends at Orbitz, they  
19 don't seem to be content to dominate the airline  
20 travel distribution market. They went from six months  
21 out of nowhere to be the third largest online travel  
22 agent. They're not only trying to live up to the  
23 early code name of T-2 or Terminate Travelocity, but  
24 now they want to dominate computer reservation systems  
25 and reinfect CRSs with dominant carrier ownership at



1 the very time when the market place is making a very  
2 healthy move toward complete divestiture.

3           But I think we've all learned the hard way  
4 that airline ownership of distribution channels is bad  
5 for consumers, and excuse the economic incentives.  
6 And lest there be any doubt about our position on the  
7 Orbitz MFN -- I'm glad this came up in Hewitt Pate's  
8 confirmation hearing yesterday, that they continue  
9 seriously the ongoing investigation of Orbitz. That  
10 MFN clause is blatantly anticompetitive. It serves  
11 one purpose, to chill competition and prevent secret  
12 price discounting.

13           If an airline is contractually forced to  
14 tell the mother ship every time it wants to strike a  
15 special deal, and it's forced to offer that same price  
16 to the mother ship, it does not take a PhD in  
17 economics to figure out that that is a disincentive to  
18 competition and the lower fare likely will not be  
19 offered. We urge you, in the exercise of your 411  
20 authority -- we urge Justice to strike it down and  
21 strike it down hard and now.

22           As to their argument that they are in favor  
23 of continuing to handcuff the CRSs while getting a  
24 regulatory free pass, I think that also is  
25 disingenuous. I think the carriers owning Orbitz now

1 account for 70 percent of all tickets in the U.S.

2 Orbitz needs a head start to enter the CRS market like

3 OPEC needs a head start to open a chain of gas

4 stations.

5 MR. REYNOLDS: With respect to the MFN, most

6 favored nation, clause, isn't it akin to the CRS's

7 parity clause?

8 MR. QUINN: I don't think it is akin, and

9 for this reason. A parity clause is an exchange.

10 It's an exchange by a carrier who can agree in an

11 arm's length transaction to offer whatever fares that

12 it has available. We are interested, in the CRS world

13 -- I'm talking about Sabre and others -- of maximizing

14 the number of fares to everyone. They want access to

15 all published fares so they can distribute them to all

16 travel agents. That's what consumers want. That's

17 what businesses want. The MFN at Orbitz is all about

18 exclusivity. You offer the fare on your web site.

19 You must offer it to the mother ship, and nobody else

20 has complete access to that very critical heart of

21 inventory, which is only a few percent.

22 So I don't believe they are similar at all.

23 And I think an economist would agree with that, and I

24 invite your attention to that issue in Professor

25 Salop's paper.

1                   MR. REYNOLDS: But haven't the CRSs been  
2 able to get web fares?

3                   MR. REYNOLDS: They've been able to get a  
4 very small percentage only recently. And I think what  
5 you found was telling testimony this morning from the  
6 folks at Sendet that Orbitz in its MFN and its hold on  
7 inventory was able to strangle Trip.com and is  
8 strangling Cheap Tickets. Now Travelocity and Expedia  
9 had a market position early. But what it has also  
10 done to those sites is transformed the site in the  
11 business plan, frankly, more toward hotel and other  
12 kinds of reservations than it does on air travel. And  
13 you'll see that shift, and that shift ought to worry  
14 you from an economic perspective.

15                  You're going to have major, dominant  
16 carriers owning not only the airline distribution  
17 market, but you're soon going to have them going into  
18 the computer reservation market, and that's where this  
19 all began -- abuse by airlines owning distribution  
20 channels. This NPRM, which ought to go, ought to be  
21 all about facilitating the independence of  
22 distribution channels, online computer reservation  
23 systems.

24                  As to fare displays, I do need to touch on  
25 that. I want to be sensitive to time. But I don't

1 know where you came up with the fare display policy  
2 that you have. It's very confusing. You have to take  
3 a lot of lawyer time just trying to figure out. You  
4 say that fees below \$20 or 10 percent should be listed  
5 separately, while fees above that level should be  
6 included in the fare amount.

7           But then the language of the proposed rule  
8 requires all service fees be listed separately, i.e.,  
9 unbundled, and states confusingly that those below 20  
10 bucks or 10 percent level must be displayed on the  
11 first screen. I think that a screen -- and we brought  
12 a screen here -- any screen that shows you the price,  
13 the full, bundled price, the price I will pay by  
14 buying that ticket at the initial fare amount, is  
15 inherently not deceptive. That was your rule for some  
16 20 years, full fare.

17           Orbitz changed its business plan, sought an  
18 exemption, got one three days later from DOT, and  
19 separated out their service fee for a period of time.  
20 You accommodated them on that and said that would not  
21 be deceptive, even though it heretofore would have  
22 been. And then you changed the whole policy to  
23 endorse the Orbitz business model of listing fees  
24 separately. So now you have said that if a fee is  
25 under \$20 or 10 percent, you may not include it. You

1 can hide it. You can surprise the consumer and put it  
2 at the end.

3           We put it at the end on ours, of course,  
4 too, and there it is. But what is deceptive about  
5 listing it and bundling it from the get-go? In my  
6 view, your proposal is more deceptive to consumers.  
7 It is constitutionally suspect, unique in a commercial  
8 speech area to be regulating with a compelling  
9 government interest with evidence of true deception,  
10 which you have not pointed to, with the least  
11 restrictive means available. That is the least  
12 restrictive means available, full price. How can  
13 anything be less deceptive?

14           MR. REYNOLDS: I mean, as a basic premise,  
15 shouldn't consumers be entitled to know when a travel  
16 agent, say, charges a service fee?

17           MR. QUINN: I don't know. I care about the  
18 price I have to pay so I can comparison shop. Under  
19 your proposal -- and I'm not even sure people  
20 understand this. Under your proposal, you would allow  
21 me to hide it. You are saying that it is no longer  
22 going to be viewed as inherently deceptive to separate  
23 out your fee, so long as -- and who threw this on the  
24 dart board, I have no idea -- \$20 and 10 percent. No  
25 evidence in the record where you get that number or

1 how \$21 could be not deceptive. But you say that if  
2 it's under 20 bucks, you cannot put it in the initial  
3 fare display. That is deceptive. The Department  
4 itself is taking a deceptive act in its own fare  
5 regulations.

6 I would urge you to closely examine it.  
7 It's very confusing for even the best folks. We've  
8 had a lot of discussion and dialogue about this. But  
9 I would urge you just simply go back, you withdraw the  
10 fare proposal, you go back to full fare. That's what  
11 was not deceptive before, and it clearly is less  
12 deceptive than what the DOT envisions.

13 MR. REYNOLDS: From a consumer standpoint,  
14 isn't it beneficial for the consumer, in choosing  
15 among potential travel agencies, to know what they  
16 will be charged up front?

17 MR. QUINN: Well, the way people do it  
18 today, as you probably are doing, is to go check  
19 Orbitz, Travelocity, and Expedia, and with that,  
20 you'll buy whatever your lowest all-in price is. I  
21 don't know if I care if it's a \$20 service fee or  
22 five, I want the lowest all-in price.

23 MR. REYNOLDS: All right.

24 MR. QUINN: Thank you very much for your  
25 time.

1           MR. REYNOLDS: Thank you. Next we have the  
2 American Society of Travel Agents.

3           MR. RUDEN: Thank you very much. My name is  
4 Paul Ruden, R-U-D-E-N. I'm senior vice president for  
5 legal and industry affairs at the American Society of  
6 Travel Agents. I don't know whether this is the  
7 beginning or the end of this proceeding, or the end of  
8 the beginning. But we're glad to be here.

9           I want to make a general observation at the  
10 beginning about the existing distribution system,  
11 which to some extent gets lost in our talk about what  
12 the rules ought to be in the future and what the world  
13 might look like under different sets of rules. This  
14 existing distribution system, which is largely a  
15 traditional brick and mortar type travel agency  
16 distribution system, but now significantly  
17 supplemented by a growing Internet sector, enables  
18 millions, tens of millions, of consumers to make  
19 optimal use of the air transportation system,  
20 typically using unbiased information about a  
21 glittering array of choices.

22           Any significant interference with that  
23 mechanism runs the risk that information to consumers  
24 will become sub-optimal. And in that case, consumers  
25 are going to end up spending more money and receiving

1 less service than they would otherwise have done under  
2 the current system. That result may help the network  
3 airlines by raising their yields in the short run, but  
4 it will not help anyone else.

5           The rules proposed in this NPRM will  
6 devastate the retail travel agency business, driving  
7 out thousands more agencies and impairing further the  
8 ability of consumers to get objective information  
9 about travel options. As useful as it is, the  
10 Internet is not a substitute for CRS services to  
11 travel agencies.

12           Now we have heard much about market power by  
13 the CRSSs, relatively little about the airlines. But I  
14 am here to say that the network airlines continue to  
15 exert and have exerted for many years now enormous  
16 market power against the independent distribution  
17 system. And I would recite two examples of that.

18           MR. REYNOLDS: I was going ask, do the CRSSs  
19 have market power over the airlines or over travel  
20 agents?

21           MR. RUDEN: The original findings of the CAB  
22 were that the CRSSs had market power. The comments we  
23 have filed suggest that because of the Internet and  
24 other developments, the competition is now working  
25 very substantially throughout the marketplace. I



1 think the argument that the CRSs now making offers of  
2 discounts to the airlines, which are typically being  
3 rejected, suggest the opposite proposition, that the  
4 airlines are still in the driver's seat to a large  
5 degree. They're in effect saying that's an  
6 interesting offer. I don't accept it; make me  
7 another.

8           There is not a lot of bargaining going on,  
9 and it is I think a fair statement on what I  
10 understand the facts to be that it is the airlines who  
11 are typically refusing to negotiate, as indeed they  
12 refused to negotiate when they told the travel agency  
13 industry and proceeded to extract about \$22 billion in  
14 base commissions from them beginning in 1995, reducing  
15 agent compensation below any plausible competitive  
16 market level.

17           They have also succeeded in withholding  
18 their lowest prices from both the traditional and  
19 online distribution channels on which most consumers  
20 still rely. It is supremely ironic then that the  
21 Department would consider regulation of travel agency  
22 income and marketing, among other things, while  
23 allowing the airlines' collectively chosen instrument,  
24 Orbitz, to roam free in the marketplace, the recipient  
25 of special favors only the airlines can bestow.

1 History suggests no good is going to come of that.

2 Now everyone seems to agree on one thing.

3 The rules were originally created to correct and  
4 prevent any competitive behavior by airlines using  
5 their control over CRSs to distort air travel  
6 transportation and competition by disadvantaging  
7 travel agents in their service to consumers. Now the  
8 suggestion is -- and this is the heart and soul of  
9 this NPRM as we understand it -- that the airlines  
10 have divested their interest. There is no need for  
11 further regulation. The marketplace will govern now,  
12 as it was supposed to govern all the rest of the  
13 transportation system under the law passed in 1978.

14 The question is, are the airlines no longer  
15 influencing CRS behavior other than as mere customers?  
16 There are two massive holes in this record,  
17 unfortunately, on that question, and it's a core  
18 question. One is the question whether the announced  
19 sale of WORLDSPAN, which is owned by three major  
20 airlines, is the true end of airline control of that  
21 CRS. Given the brutalization of the retail travel  
22 industry by the major network airlines over the last  
23 eight years, you'll forgive us a little skepticism  
24 about that question.

25 Show us the deal, to quote Jerry McGuire.

1 It is the Department's responsibility, we suggest,  
2 with all respect, to know about these things before  
3 making a policy decision that affects so many  
4 businesses. And there is nothing in the record on  
5 this. We've heard lawyers talking today about what  
6 they think the facts are. It's the Department's  
7 responsibility to investigate that and to put it on  
8 the record where everyone can see it.

9           The same is true of the other major hole.  
10 What is the nature and effect of the marketing  
11 relationships between the airlines and the CRSs? With  
12 those questions unanswered, assurances from the  
13 Department that it will commit the needed resources  
14 and zeal to enforcing section 411 in a deregulated  
15 marketplace are very little solace to us, especially  
16 given that travel agents have effectively been  
17 excluded from using section 411 as a remedy, and given  
18 the history of lack of enforcement against tying  
19 practices in the industry, as detailed in Amadeus's  
20 opening comments.

21           If these issues can be resolved, however,  
22 then we agree that an appropriate transition to  
23 deregulation could begin. A movement to deregulation  
24 under those circumstances would not only be  
25 acceptable, but highly desirable when contrasted with

1 proposals in the NPRM, which in all events should not  
2 be adopted. How you get there is very difficult.

3 WORLDSPAN has suggested that there is much  
4 more to these marketing relationships than meets the  
5 eye, in its April 10 pleading in this case. Amadeus's  
6 opening comments also talk about these agreements in  
7 ways that are very interesting. There is nothing in  
8 the record about it, except that American Airlines  
9 thinks they're not very important, although it and all  
10 the others tend to keep them.

11 MR. REYNOLDS: Do you believe as a  
12 proposition that it's true that the CRS without any  
13 airline ties could not easily compete in the CRS  
14 business in terms of the marketing ties or other  
15 relations?

16 MR. RUDEN: Well, I think the CRSs are fully  
17 capable of competing as independent businesses without  
18 either control or financial ties or marketing  
19 relationships with individual airlines, and do it  
20 quite well.

21 I'd next like to talk, in the interests of  
22 time, about the myth of multiple CRS use, which I  
23 think has not been touched on in any comments I've  
24 heard today. Much of the rules that are proposed in  
25 the NPRM depend upon the concept that travel agents

1 typically use only one CRS, and that if they were able  
2 to use more, things would be better. Booking fees  
3 might go down and so forth.

4 Now we, along with Sabre and others, have  
5 shown, based on reliable data about current market  
6 practices, two fundamental facts. One, most agencies  
7 who could make use of multiple CRSs are already doing  
8 so. The rest don't want them, don't need them, and  
9 will not use them no matter what the regulations say.

10 MR. REYNOLDS: Of those who use more than  
11 one system, how extensive is the use of the systems?  
12 Is it even if they've got two, or do they tend to  
13 favor one over others?

14 MR. RUDEN: I think -- it is my personal  
15 view, and I can't speak to this as a witness because  
16 I've never actually observed this. But it is my  
17 belief because it is typically the larger agencies who  
18 tend to be bigger players in the business marketplace,  
19 they are using the CRS that the client wants used  
20 because of relationships with the airline that have to  
21 do with fare discounts made available to them. If  
22 you're a big player in the corporate marketplace, you  
23 may have to have multiple CRSs simply to satisfy those  
24 demands by airlines in different marketplaces with  
25 different customers.

1           MR. REYNOLDS: Well, then as a basic  
2 proposition, is it true that most individual travel  
3 agency offices use one system for all or most all of  
4 their booking?

5           MR. RUDEN: Absolutely. The industry is 80  
6 -- I don't have the numbers readily at hand. They're  
7 in the national commissioned study. Eighty-plus  
8 percent of the agencies sell less than \$2 million  
9 worth of air transportation. They all have one CRS.  
10 The next group, which takes you up to a 92 or 93  
11 percent market share of total agency sales, firms up  
12 to \$5 million. And I think it's a pretty good bet  
13 that all of those have only one.

14           So the overwhelming majority of the business  
15 enterprises in the travel agency sector use one. And  
16 they will never use more than one. It's, simply for  
17 the reasons we outline in detail in our testimony,  
18 inefficient and impractical to do so.

19           Now the error that the rulemaking makes in  
20 this respect is not just the detail. It's very  
21 fundamental because it leads to proposals to micro-  
22 regulate the most competitive part of this business by  
23 banning, among other things, competitively determined  
24 CRS usage inducements to travel agencies. This  
25 rulemaking, quite extraordinarily, would shift the

1 last supplier-based income stream away from travel  
2 agents through CRSs and back to the network airlines.

3           No regulatory flexibility analysis of the  
4 impact of doing that was included in the rulemaking.  
5 This is something that was observed by a number of  
6 parties, in addition to ASTA, among them the Small  
7 Business Advocacy Office.

8           Now let me turn to the MIDT tapes. You've  
9 heard much about this today, and there are many words  
10 on it in the pleadings. An extraordinary percentage  
11 of the words in this proceeding are devoted to this  
12 curious subject. The airlines appear to want this  
13 information very badly. And some of it probably has  
14 legitimate and pro-competitive purposes, for example,  
15 route planning. ASTA does not want to interfere with  
16 that legitimate activity.

17           On the other hand, there are some real  
18 curiosities about this subject. One is that the  
19 airlines, while they want the data, are not willing to  
20 pay for it, or at least be in a position of having to  
21 bargain to pay the travel agents who generate the  
22 data. It is also curious that none to my knowledge  
23 have argued that CRSs overcharge for the data, even  
24 though they appear to have a monopoly on its  
25 production. This is a strange omission from airlines

1 that constantly argue that monopolistic CRSs are  
2 gouging them with excessive booking fees.

3           It's also true that non-airline override  
4 compensation arrangements persist in other product  
5 sectors of the travel business, and they seem to work  
6 fine without the suppliers sharing this kind of real-  
7 time information.

8           Finally, it would seem that the airlines'  
9 campaign to avoid booking fees through direct connect  
10 technology, among other things, is actually reducing  
11 the availability and scope of the MIDT data generated  
12 by the CRSs. The airlines are thus arguing that they  
13 cannot live without the data, while simultaneously  
14 reducing their own access to it as well as its value.

15           To be clear about what we're looking for,  
16 perhaps the best solution to this would be to remove  
17 the rule entirely that deals with this subject.  
18 Travel agents would then be in a position to bargain  
19 with airlines for access to the information that the  
20 agents generate. A market price would quickly be  
21 established for this data, and the airlines would then  
22 get all the information they were willing to pay for.  
23 Then they could do pretty much everything that they  
24 do with the data today.

25           We think this rule is a prime candidate for



1 simply letting the market work, assuming as always  
2 that airline relationships with the CRSs don't  
3 interfere. Yes, sir.

4 MR. REYNOLDS: On a related point -- and it  
5 has come up earlier today as part of a discussion --  
6 what abuses, if any, have occurred from the major  
7 airlines' access to MIDT data with information on each  
8 travel agency's bookings?

9 MR. RUDEN: I'm glad you asked that. It has  
10 come up a number of times, and I noticed that all of  
11 the parties who have tried to respond to it lack  
12 specific information. I, too, lack that information,  
13 and there is a reason why this is the uniform answer  
14 that you get, and it's important to understand what  
15 that reason is. Airlines have a life and death threat  
16 over every travel agency that disputes them. If a  
17 travel agency were to complain to a public body, for  
18 example, like a court about abuses or what the agent  
19 judged to be abuses of this MIDT data, the first thing  
20 that would happen, typically, is the airline would  
21 terminate the agency relationship. And the courts  
22 have made clear they will not interfere in this  
23 activity.

24 And so anyone who wants to challenge an  
25 airline's use of this data or, for that matter, almost

1 to dispute anything else, if you are a travel agent,  
2 you are inviting the termination of your business  
3 relationship probably for all time. As a result of  
4 this, travel agents are extremely reluctant to come  
5 forward with this information. We've heard endless  
6 anecdotal cases, reports of it, but I can't document  
7 them for you because it would require us to reveal  
8 information that would be fatal to their businesses.

9 MR. REYNOLDS: But you do believe that such  
10 occurrences have happened?

11 MR. RUDEN: Yes, I do believe it. Finally,  
12 I'd like to touch briefly on the subject of agency  
13 service fees. It was discussed just a moment ago.

14 MR. REYNOLDS: Unfortunately --

15 MR. RUDEN: I'm sorry. I guess I'll have to  
16 touch on it in our pleading.

17 MR. REYNOLDS: Thank you very much. Next,  
18 we have Expedia.

19 (Pause.)

20 MR. BRITTON: Good afternoon, Assistant  
21 Secretary Reynolds and the others on the panel.

22 MR. REYNOLDS: Deputy assistant secretary.

23 MR. BRITTON: Excuse me. I'm trying to  
24 promote you prematurely, but take that as a  
25 compliment.

1 MR. REYNOLDS: Thank you.

2 MR. BRITTON: I'm Mark Britton, the senior  
3 vice president, general counsel, and secretary of  
4 Expedia, Inc. Expedia appreciates the opportunity to  
5 appear before you to discuss the Department's NPRM  
6 regarding its CRS regulation and to answer any  
7 questions that the Department may have. Expedia has  
8 submitted several rounds of comments. I intend to  
9 only briefly highlight those issues of principal  
10 concern to Expedia.

11 As an overview, allow me to first summarize  
12 Expedia's overall position. First and foremost, we  
13 believe that CRS rules should be allowed to sunset as  
14 they are currently scheduled, and inherent in this, we  
15 also believe that the proposed rules are flawed.

16 There is broad agreement that the goals of  
17 this proceeding must be to promote consumer welfare  
18 and competition. We believe that sunseting the  
19 current rules and not adopting the proposed rules is  
20 the best way to achieve these goals. This will allow  
21 the market to operate freely, and a free market will  
22 allow innovation to be driven by consumer interests  
23 and will permit market participants to adapt to their  
24 business models and practices to serve consumers.

25 Within that framework, we would like to make

1 the following observations. The first observation is  
2 that deregulation is appropriate and necessary at this  
3 time. We are prepared to embrace deregulation and  
4 believe that the DOT should be prepared to as well  
5 because, in the 19 years since the initial  
6 promulgation of the CRS regulations, the world has  
7 dramatically changed.

8           While at one time, air travel distribution  
9 was dominated by a small group of CRSs owned and  
10 controlled by major airlines, today's market is much  
11 more open. Airline ownership will soon disappear  
12 completely, and the Internet has emerged as a major  
13 force in air travel distribution and will soon account  
14 for approximately 30 percent of air travel sales.

15           The fundamental reasons for the regulations  
16 of CRSs, therefore, no longer apply.

17           MR. REYNOLDS: Is the 30 percent by revenue  
18 or by number?

19           MR. BRITTON: You've asked that so many  
20 times, you would probably appreciate an accurate  
21 answer, but I do believe that that is based on gross  
22 bookings.

23           In this regard, Expedia was pleased, but not  
24 surprised, to find a strong consensus in favor of  
25 deregulation in the recent round of comments. A large

1 cross-section of the industry, including airlines,  
2 CRSs, and travel agents, recognize that the time has  
3 come to allow CRS regulation to come to an end.  
4 Indeed, it should not be lost on DOT that support for  
5 full and prompt deregulation is embraced by United  
6 Airlines, WORLDSPAN, and Expedia, companies from each  
7 of the principal levels of air travel distribution.

8           As a second observation, if the Department  
9 concludes that there must be a transition period, we  
10 will be it should be brief. Ideally, the CRS rules  
11 should simply sunset at the end of January 2004, and  
12 the Department should maintain the current rules until  
13 that time. And irrespective of the duration of the  
14 transition, the proposed CRS rules are fundamentally  
15 flawed and cannot serve as the basis for that  
16 transition.

17           The proposal rests on questionable statutory  
18 grounds and is slanted significantly in favor of  
19 carriers, especially the largest ones. It would  
20 loosen or remove restrictions on airlines without  
21 offering comparable freedom to CRSs. Such an outcome  
22 will make the transition to a deregulated system more  
23 difficult. It would be far better to maintain the  
24 status quo for a brief period of time than to have  
25 this heavily distorted structure become the basis for

1 a transition rule.

2 MR. REYNOLDS: What are the questionable  
3 statutory grounds that you mentioned?

4 MR. BRITTON: You've probably heard it so  
5 many times today, that you're hoping to hear it one  
6 more time, but we certainly agree with many of the  
7 earlier commenters today with respect to the  
8 Department's authority to regulate CRSs under Section  
9 411. The earlier comments that seem so long ago, by  
10 Mr. Schwarte, and speaking to the fact that they are  
11 not an agent or interfacing with customers, we would  
12 agree with that position.

13 Our third observation is that, in a  
14 deregulated marketplace, the enforcement process will  
15 and must remain available to address anticompetitive  
16 conduct. While Expedia believes the regulation should  
17 be allowed to expire, we also recognize the need for  
18 case-by-case enforcement to preserve competition in  
19 our travel distribution. Rather than preserving  
20 outdated regulations or implementing new and confusing  
21 ones, consumers will be best served by the enforcement  
22 arms of the DOT, Department of Justice, Federal Trade  
23 Commission being vigilant in maintaining such  
24 competition.

25 MR. REYNOLDS: But are you saying that DOT,

1 though, doesn't have enforcement authority over CRSs  
2 as well?

3 MR. BRITTON: One thing that DOT absolutely  
4 has authority over is anticompetitive practices or  
5 consumer deceptive practices in airline distribution,  
6 and we would advocate that they continue to exercise  
7 that enforcement authority aggressively. In fact, one  
8 area where enforcement authority must be exercised is  
9 in connection with the airline joint venture, Orbitz.  
10 Put simply, Orbitz is harming competition in airline  
11 distribution, and in the proper light, Orbitz  
12 represents a return to the original, airline-owned,  
13 CRS model, complete with many of the risks that led to  
14 the original regulation.

15 Orbitz's Most Favored Nations clause has a  
16 chilling effect on the decisions of airlines to offer  
17 discounted fares and virtually denies availability of  
18 many of the most attractive discounts to other online  
19 travel agencies.

20 MR. REYNOLDS: What is Orbitz's market  
21 power? I mentioned this to a previous presenter.  
22 What is the market power that would justify extending  
23 regulations to them if market power has been the  
24 justification for imposing regulations on the CRSs, at  
25 least in the past?

1           MR. BRITTON: Sure. The regulation on the  
2 CRSs in the past has been due to the market power, not  
3 only in the CRS itself but by the airlines that  
4 control them. That is no different with Orbitz today.  
5 You're taking approximately 80 percent of the lift in  
6 the United States and pouring most-favored love on  
7 that one travel agent. That market power,  
8 collectively brought into that single channel to the  
9 extent that it is exercised, to the exclusion or to  
10 the detriment of competition, I believe, is the only  
11 justification that the Department of Transportation or  
12 any other federal agency would need.

13           MR. REYNOLDS: But it's still the number-  
14 three, online travel agency, and is Expedia number  
15 one?

16           MR. BRITTON: Well, it is number three in  
17 terms of gross bookings. If you look at where it is  
18 with respect to the sale of airline tickets on certain  
19 days, there is really no winner in the sale of airline  
20 tickets.

21           I would like to point out that prior to  
22 Orbitz's launch in the summer of 2001, they were at  
23 zero. Within eight months, they were selling a  
24 billion dollars in airline tickets. I believe that  
25 that is probably the fastest growth of any startup in



1 the history of mankind as we know it.

2           So now, from an air perspective, you have  
3 three larger participants. You have Orbitz, you have  
4 Expedia, and you have Travelocity, but they are third  
5 when you look at their overall gross bookings of air,  
6 car, and hotel. I think that Mr. Quinn, speaking on  
7 behalf of Travelocity, made an excellent point when he  
8 pointed out that we, someone like Expedia or someone  
9 like Travelocity, has continued to maintain a certain  
10 level of gross bookings because we have diversified  
11 into hotels and cars and other types of travel  
12 products.

13           MR. REYNOLDS: Do you have any evidence that  
14 Orbitz has been used to interfere with airline  
15 competition, that it's been used by its owners, the  
16 major carriers that own it, to prejudice competition  
17 vis-a-vis nonairline owners?

18           MR. BRITTON: We have presented reams of  
19 evidence to various individuals and groups at DOT. We  
20 believe that, in general, whether we're speaking about  
21 Orbitz's effect on other travel agents, whether you're  
22 speaking to Orbitz's effect on small carriers, whether  
23 you're speaking to Orbitz's effect on non-Orbitz  
24 owners, we believe that in all of those areas there is  
25 evidence that Orbitz and its owners are engaging in

1 noncompetitive practices, and to the extent that you  
2 would like to continue that dialogue, we would love to  
3 come see you.

4           The fourth observation is that the  
5 Department has correctly declined to impose CRS  
6 regulations on the Internet. The Internet's basic  
7 strength is its ability to promote free and open  
8 competition. It is precisely this freedom that has  
9 made the Internet a major competitive force in the  
10 opening of airline distribution channels. By its very  
11 nature, the Internet allows for a broad, transparent  
12 display of travel options with the capability of  
13 rapid, comparison shopping among different vendors.

14           We fully support the Department's decision  
15 not to impose CRS-style regulation on the Internet.  
16 However, curiously, and I would say, disturbingly, the  
17 DOT's service fee proposal goes in the entirely  
18 opposite direction with respect to service fee  
19 disclosure.

20           So this leads me to my final observation,  
21 but it is a point that is of great importance to  
22 Expedia, and this observation is that the Department's  
23 proposed service fee regulation should be withdrawn.  
24 The Department service fee proposal is perhaps the  
25 most ill-conceived part of the MPRM. Again, while the

1 Department has wisely proposed to abstain from general  
2 regulation of the Internet, it has proposed a service  
3 fee regulation that is highly intrusive.

4           The Department is now, if we understand the  
5 revised proposal correctly, and I'm glad to hear from  
6 Mr. Quinn that there are others who are as perplexed  
7 as we are, considering the rule is requiring the  
8 disclosure of service fees up to a level of \$20, or 10  
9 percent -- excuse me -- the Department is requiring  
10 the breakout of fees over a level of \$20, or 10  
11 percent of the applicable fare, but requiring that  
12 fees be bundled under this amount.

13           So when we look at the history of the DOT's  
14 policy with respect to service fees, we start with 20  
15 years of history, and then we have the Department  
16 going from a policy of requiring service fees to be  
17 bundled with the air fares to one permitting Web sites  
18 to offer unbundled disclosure at their option to now a  
19 proposed policy requiring unbundled fees in some cases  
20 and bundling in others.

21           This zig-zagging approach to enforcement  
22 policy is, frankly, very confusing. Add to this the  
23 ironic fact that Orbitz, the party which sought the  
24 policy change originally, has evidently flip flopped  
25 and no longer itemizes its service fee. Again, this

1 is monumentally confusing for us. But not  
2 withstanding this confusion, we do empathize with  
3 Orbitz and its change to its service model because we  
4 believe that their actions demonstrate that travel  
5 merchants need the freedom to innovate and adapt to  
6 consumer demands.

7 MR. REYNOLDS: That was a basic premise,  
8 though, as I believe I asked of Mr. Quinn, shouldn't  
9 consumers be entitled to know up front when a travel  
10 agency charges a service fee, whether on line or brick  
11 and mortar?

12 MR. BRITTON: Well, the answer is no or  
13 maybe. I fundamentally don't agree with the  
14 proposition. I think that consumers need to choose  
15 what they want to see, whether you go to a good or  
16 service, and there has not been any choice, whether it  
17 be the FTC or whoever might regulate those and many  
18 other industries, to mandate some sort of bundling or  
19 unbundling of the markup.

20 In that regard, we, in our comments, pointed  
21 out the other federal agencies that have adopted a  
22 more flexible approach to similar disclosure issues by  
23 allowing or proposed to allow parties to choose  
24 whether or not to bundle fees and charges. For  
25 example, the Department of Housing and Urban

1 Development is proposing to allow optional bundling of  
2 closing costs and changes in real estate settlements,  
3 and, similarly, joint FTC and FCC policy statements  
4 relating to long-distance advertising require  
5 disclosure but do not mandate bundling.

6           We note further that there has been no  
7 demonstration of a serious consumer problem regarding  
8 service fee disclosure that requires regulatory  
9 action. Again, we can make guesses, or we can make  
10 presumptions as to what consumers want, but, again, I  
11 don't believe there has been any evidence that there  
12 is a problem. Expedia has received no complaints  
13 concerning its practice of bundle disclosure, and we  
14 are also not aware of any public enforcement actions  
15 with respect service fee disclosure in general.

16           And so I would close by saying that perhaps  
17 the number and variety of regulatory solutions that  
18 the Department has adopted in its zig-zagging approach  
19 to service fee regulation; perhaps that's a reflection  
20 of the fact that no consumer problem has been  
21 identified.

22           MR. REYNOLDS: Thank you very much.

23           MR. BRITTON: Thank you for your time.

24           MR. REYNOLDS: Next, we have the Large  
25 Agency Coalition.

1           MR. PESTRONK: My name is Mark Pestronk,  
2 P-E-S-T-R-O-N-K. It's a difficult name, so I've given  
3 the reporter my business card.

4           In all seriousness, Mr. Reynolds, what the  
5 Department has proposed to do to travel agencies of  
6 all sizes would be a tragedy. Outlawing productivity  
7 pricing would put large and productive, as well as  
8 small, mom-and-pop, travel agencies, out of business,  
9 and if not out of business, then their service fees  
10 would have to go up in proportion to any lost revenue.

11          MR. REYNOLDS: With respect to your members  
12 and the members of your coalition, do most of the  
13 revenues for the sale of airline tickets come from  
14 overrides paid by the airlines or per-booking  
15 incentive payments by the CRSs?

16          MR. PESTRONK: They come from service fees  
17 paid by clients.

18          MR. REYNOLDS: That's the principal source  
19 of revenue for your agencies.

20          MR. PESTRONK: Yes. To take an example, if  
21 the ticket price is \$400, the typical service fee  
22 charged by a large agency would be about \$30 or \$35.  
23 A typical override would be about one or two percent  
24 of the ticket price for \$8. A typical GDS bonus,  
25 assuming that \$1.50 per segment is about right,

1 although I think that's high, would be two times  
2 \$1.50, or \$3.

3           Nevertheless, most transactions have two,  
4 three, or even four segments per reservation, so we're  
5 talking about \$3 or \$4.50 or even \$6. Altogether,  
6 it's a very significant amount of money, without which  
7 many travel agencies could not be in business, without  
8 which many large, corporate travel agencies would not  
9 be able to offer the services that they offer today.

10           I called this a tragedy not because it's  
11 going to put the travel agencies out of business or  
12 make for financial harm; it's a tragedy because it's  
13 all utterly unnecessary. I say it's unnecessary  
14 because the Department's rationale for outlawing  
15 productivity pricing is based on an outdated set of  
16 facts. It is simply not true that productivity  
17 pricing, the basic system of quotas, penalties, and  
18 incentives, keeps travel agencies off the Internet.  
19 It can't be truth mathematically.

20           Let's deal with some facts on the ground.  
21 The most important fact we heard today, I think, of  
22 all was a fact from Professor Salop, the Georgetown  
23 Law School professor speaking for Sabre. Professor  
24 Salop noted that only two percent of all fares are e-  
25 fares, whether that's by volume or number of tickets.

1 It doesn't really matter. We're dealing with two  
2 percent, maybe three percent if it's by volume.

3 At present, well, if only two percent of  
4 fares are e-fares, then it can't be true that  
5 productivity pricing deters travel agencies from using  
6 the Internet and booking these fares.

7 As we pointed out in our comments, the  
8 typical, productivity pricing quota today is in the  
9 range of 30 percent below a travel agency's current  
10 level of productivity. In other words, typically,  
11 under offers being made today, travel agencies can  
12 afford to shift up to 30 percent of their bookings out  
13 of the CRS into another system or onto the Internet  
14 without incurring any penalties, without incurring  
15 penalties, and it's the possibility of penalties that  
16 causes you to consider outlawing productivity pricing  
17 because here is what the NPRM said. He said, "The  
18 system's productivity pricing structure seemed to  
19 deter travel agents from using the Internet. When  
20 travel agents book e-fares through the Internet, they  
21 run the risk of failing to satisfy the minimum monthly  
22 booking quota set by the productivity pricing  
23 provisions."

24 That was your concern. I'm here to tell you  
25 that that is mathematically impossible. A travel



1 agency today can move as much as it possibly can onto  
2 the Internet and book e-fares and fares that are not  
3 available in a CRS, and yet it's not in danger of  
4 going below its quota and incurring a penalty.

5           What's more, the trend in quotas is down,  
6 down, down. Large travel agencies today can get  
7 contracts with booking quotas that are about 50  
8 percent of their current productivity. We pointed  
9 that out in our comments, too. That means that they  
10 can afford to book 50 percent of their business on the  
11 Internet without incurring any penalty.

12           MR. REYNOLDS: I believe it was American  
13 Airlines earlier today that was speaking of the fact  
14 that the booking-fee market is dysfunctional because a  
15 decrease in the booking fees will not essentially  
16 generate incremental bookings because, if you've got  
17 productivity pricing, that would actually reduce the  
18 revenues for the travel agents, who get essentially a  
19 share of that. So how do you respond that  
20 productivity pricing is essentially enabling a  
21 dysfunctional market, and can you name another market  
22 that operates in that way?

23           MR. PESTRONK: Yes, I can. Every other  
24 travel service that is sold is sold where the revenue  
25 rises in proportion to the amount of sales and

1 decreases in proportion to the amount lost. In fact,  
2 in the travel business, it's normal for the travel  
3 suppliers to pay directly through commissions or  
4 indirectly through a flow-through apportion of the  
5 booking fees to compensate the travel agency for its  
6 services.

7           In fact, I would say what is perverse about  
8 what American is engaged in is offering no  
9 compensation. America, in its comment, says: "Travel  
10 agencies offer no added value for operating the cash  
11 machine," that is, the CRS. America is forgetting  
12 that the travel agencies are making reservations on  
13 that airline, and every other travel supplier outside  
14 the airline business pays for that service.

15           The fact that American is paying indirectly  
16 through booking fees upsets American, and American is  
17 asking you to bring about a result which American  
18 wants, the result being that American shouldn't have  
19 to pay indirectly either, but I see no perversity in  
20 being paid for service.

21           MR. REYNOLDS: I think their point, and this  
22 is it, is there any validity to the thought that there  
23 is no competition among the CRSs in terms of the  
24 booking fees because to cut them would reduce the  
25 travel agents, the subscribers, who would have less

1 incentive to choose a particular CRS. If it cut its  
2 booking fees, well, then that's going to the bottom  
3 line of the travel agents. Therefore, they would  
4 shift somewhere else, so there is no incentive, in  
5 that sense, to compete for booking fees.

6 MR. PESTRONK: But that's simply a  
7 description of the temporary market and any given  
8 snapshot of the market. The overall trend is as there  
9 become viable alternatives to the CRS, booking fees  
10 must go down, as a matter of supply and demand.  
11 Therefore, incentives will have to go down, too.  
12 Travel agencies expect that. They expect that the  
13 long-term trend is that the revenue gained through use  
14 of the CRS will go down but that, hopefully, travel  
15 suppliers will continue to see the light and  
16 compensate travel agencies otherwise. Northwest, for  
17 example, offers inducements for travel agencies to  
18 book on its Web site.

19 One of the biggest ironies of this entire  
20 industry is that the loudest complainer about travel  
21 agencies being stuck with long-term contracts is  
22 American Airlines, and American prohibits travel  
23 agencies from booking on aa.com. No travel agency is  
24 allowed to do it. Travel agencies may do it, but it's  
25 done without the consent of American, and if you ask

1 American, the answer is that no travel agency is  
2 allowed to book on their Web site. So where do travel  
3 agencies go? If they lose their productivity pricing,  
4 and they gain nothing through the CRS, they still  
5 won't be able to book on aa.com, a most ironic result.

6           The general trends of quotas is down. We  
7 expect that the general trend of incentives offered by  
8 the CRS vendors is going to go down. Travel agencies  
9 expect to be able to make more and more bookings  
10 outside the CRS. They welcome it in a lot of cases,  
11 and the CRS vendors themselves are really falling all  
12 over themselves to try to incorporate Web-only  
13 bookings into the CRS. There is a company, I think,  
14 in Atlanta called -- it's a funny name, but three out  
15 of the four vendors use it to incorporate Web-only  
16 displays into the CRS, and that's available today;  
17 Farechase, that's what it is. And as far as I know,  
18 every airline except American is allowing travel  
19 agencies to book that way.

20           Another interesting development on the  
21 ground is that travel agencies that don't want any  
22 quota are able to get a quota-less contract from any  
23 of the vendors. Sabre calls its plan the "Sabre  
24 Simplicity Plan." Galileo has "Select and Connect."  
25 WORLDSPAN has the "Home-free System," and Amadeus has

1 "Easy Access." Under these, any travel agency can  
2 sign a contract now with no quota and, of course, no,  
3 or very low, incentives. No such travel agency would  
4 have any difficulty at all making bookings outside the  
5 CRS.

6           And, by the way, I agree with ASTA  
7 completely that there is no functional benefit to  
8 multiple systems. The vendor representatives here,  
9 please close your ears, but except for the fact that  
10 Southwest isn't owning one of them, there really isn't  
11 any discernable difference between the systems, among  
12 the systems, none whatsoever.

13           Okay. You can open your ears again. And so  
14 the reasons that travel agencies, including my clients  
15 in the Large Agency Coalition, have multiple systems,  
16 in some cases, three systems, are really threefold.  
17 First, the on-site client requires a system because  
18 it's always had that system; second, the travel agency  
19 has expanded into a city where, because of the tying  
20 between the owning or the affiliated airline and the  
21 CRS, it's necessary to have that CRS -- I'll give you  
22 examples of that, if you would like to; and, third,  
23 where travel agencies acquire other travel agencies,  
24 often the seller has a separate system, and then dual  
25 systems have to be maintained. But for those three

1 unusual situations, dual systems are quite unusual in  
2 the business.

3 MR. REYNOLDS: You've passed your three-  
4 minute warning. I don't know if you've concluded your  
5 remarks or not, but --

6 MR. PESTRONK: I have concluded them. Thank  
7 you.

8 MR. REYNOLDS: Thank you. You undoubtedly  
9 heard the discussion regarding MIDT data. Are you  
10 aware of any abuses that have occurred from major  
11 airlines' access to such data with information on each  
12 travel agency's bookings?

13 MR. PESTRONK: Yes. It happens in the  
14 micro-sense as follows. A sales representative from  
15 an airline will visit the headquarters of the travel  
16 agency and say to the travel agency executive, "I see  
17 that you have 50 travelers going to the Orient next  
18 month on the other airline. Why don't you put them on  
19 our airline, and we'll give you the following  
20 inducement?"

21 Worse, they may go directly to the  
22 corporation which has the 50 travelers and say, "Why  
23 don't you cancel all of those reservations and come  
24 with us?"

25 I would definitely consider those

1 competitive abuses as well as invasions of privacy.

2 And I note that although the representative of Sheperd  
3 said that passenger names are not part of their data,  
4 most corporations, large corporations, have on-site  
5 offices where it's clear that everybody at that on-  
6 site office belongs to the corporation, so, in effect,  
7 the clients are identifiable.

8 MR. REYNOLDS: Do you know anyone who would  
9 be willing to come forward with specific instances of  
10 such behavior?

11 MR. PESTRONK: I don't right now.

12 MR. REYNOLDS: Okay.

13 MR. PESTRONK: I can certainly supplement  
14 the record if I can come up with someone.

15 MR. REYNOLDS: Certainly. Well, thank you  
16 very much.

17 Next, I believe we have Stratton Travel  
18 Management.

19 THE WITNESS: Hi. My name is Terry McCabe.  
20 Thank you for the opportunity to appear today to  
21 share some insights on the impact of the DOT's CRS  
22 rule proposal on a real world travel agency.

23 My name is Terry McCabe, and I am the  
24 president of Stratton Travel Management, a \$90 million  
25 company headquartered in Northern New Jersey employing

1 124 people. While I'm here today on behalf of  
2 Stratton Travel, you should know that I am not alone  
3 in my outrage of the DOT's rules proposal.

4 Earlier this month I submitted to the docket  
5 a statement signed by 456 U.S. travel agents of all  
6 sizes who are opposed to the Department's NPRM. And  
7 as this rulemaking proceeds, I expect you will hear a  
8 great deal more from parties opposed to this  
9 misguided, paternalistic approach.

10 I asked to participate in this hearing today  
11 because I believe the Department's NPRM is bad for my  
12 business and bad for my customers. The marketplace  
13 has changed tremendously since the CRS rules were  
14 first adopted in 1984. The rules were adopted then to  
15 protect consumers and their travel agents from the  
16 airlines that owned the distributions systems.

17 Today, the major CRSs in this country have  
18 been or are about to be divested of their airline  
19 ownership. The Department has responded to this  
20 change in exactly the wrong way by proposing rules  
21 that deregulate the airlines while increasing the  
22 regulation of travel agents and CRSs. It is no secret  
23 that this is a tough time to be a travel agent.  
24 Everyone in the travel business has been hurt by  
25 September 11th, by a weak economy, by SARS and by the



1 continuing threat of terrorist acts. The list just  
2 goes on.

3           Unfortunately, it appears that the  
4 Department of Transportation is responding to these  
5 challenging times by issuing an NPRM that will only  
6 make things worst by saddling agents and CRS with  
7 onerous rules while letting the airlines run free.

8           MR. REYNOLDS: I'm sorry, are you favoring  
9 total deregulation then, is that your position?

10          THE WITNESS: Uh-huh.

11          MR. REYNOLDS: I'm sorry, continue.

12          THE WITNESS: The reality is that while  
13 there are significant problems in the industry as a  
14 whole, parts of the system work very well, including  
15 the CRS/agency relationship. This part of the market  
16 that is working most competitively is what the DOT  
17 wants to regulate most aggressively. In that regard,  
18 this NPRM is filled with solutions in search of  
19 problems.

20           I imagine that the Department continues to  
21 be very concerned about the health of the airline  
22 industry and to seek avenues of relief for the  
23 carriers. Reading this NPRM, one might believe that  
24 CRSs and travel agents are the problem. I can assure  
25 you that we are not. I cannot help but wonder if the

1 interest of travel agents, the CRSs they use and the  
2 consumers we serve are being sacrificed by the  
3 Department of Transportation for the interest of the  
4 airlines.

5           The Department has proposed partial  
6 deregulation. They've picked the wrong part to start  
7 with. If this industry is to be deregulated, and the  
8 time for that may well have come, that deregulation  
9 should come with the assurance of vigilant anti-trust  
10 and consumer protection enforcement to deal with the  
11 problems the airlines have created and I fear may  
12 continue to create in the industry.

13           I have looked at what the NPRM would do to  
14 my business, and I'm extremely concerned. Taken as a  
15 whole, I cannot help but wonder whether the agency  
16 that regulates my business understands what's actually  
17 happening in my business in 2003.

18           I would like to spend a few minutes  
19 discussing some of the specific issues that I find  
20 most problematic. First, the length of my contract  
21 with my CRS provider -- on the most basic level I have  
22 to ask why the Federal Government is telling me how  
23 long my contract can be. When it comes to contracts,  
24 the marketplace is working. Many travel agents  
25 renegotiate their contracts before their expiration,

1 so there's no need for the government to reduce the  
2 maximum length to three years. Other agencies might  
3 prefer to have contracts longer than five years if it  
4 makes sense for their businesses. I do not believe  
5 that there's any reason for the government to dictate  
6 the terms of my CRS contract. Get the government out  
7 and let me sign the contract that works best for my  
8 company.

9           Second, the financial terms of CRS  
10 contracts. I've watched my base commissions drop to  
11 zero. Now that the airlines have eliminated  
12 commissions, the Department of Transportation, in a  
13 proposal that is heavily cued towards major airlines,  
14 seeks to eliminate yet another income stream by  
15 prohibiting productivity pricing. The incentive an  
16 agency gets from a CRS in exchange for booking a  
17 certain amount through that system are in many cases  
18 the only source of significant income they've got left  
19 aside from customer paid service fees.

20           For many travel agencies, the service fees  
21 they charge customers are as high as they can go.  
22 Customers simply won't pay anymore. Many agencies  
23 rely on the productivity revenue to stay in business.  
24 I cannot understand why the Department has proposed  
25 this approach. The DOT seems to be trying to push all

1 consumers into the arms of the airlines via the  
2 Internet in order to wring costs out. But I know that  
3 not everyone can or will go to the Internet.

4 I would suggest that every travel agency  
5 among the 456 who filed on May 2nd have customers with  
6 special needs or who do not have access to on-line  
7 booking tools. The assumption that every citizen of  
8 this country is wired to the Internet with access to  
9 on-line booking tools is quite simply fallacious.  
10 Airline controlled distribution systems certainly have  
11 their place, but if they're the only game in town the  
12 consumer will not be best served and it will  
13 inevitably lead to narrower and more expensive choices  
14 for the traveling public.

15 There is no justification for a ban on  
16 productivity pricing. These types of arrangements  
17 exist in many other industries. If someone makes an  
18 investment in my business, they're entitled to some  
19 assurance of a return on that investment. It's as  
20 simple as that. The fact that the DOT seems to ban a  
21 CRS from requiring a percentage of an agent's bookings  
22 be through the CRS unfortunately demonstrates the  
23 Department's lack of understanding of the marketplace.

24 Given the uncertainty of the travel business  
25 right now, most agents prefer not to be locked to a

1 fixed number. Agreeing to book a percentage through a  
2 CRS makes more sense for them since it is so hard to  
3 predict how many bookings they will have in a given  
4 month.

5           Third, the myth that CRSs are locking up  
6 subscribers -- once again, the Department has  
7 demonstrated a lack of understanding here. The DOT  
8 seems to be under the impression that travel agencies  
9 want to use multiple CRSs. From a business  
10 perspective, this just doesn't make sense. While the  
11 basic functions are the same, these systems are not  
12 easily interchangeable. I would have to retrain my  
13 entire staff to use multiple systems or have agents  
14 dedicated to each system. This approach did not work  
15 for us in the past and it certainly doesn't make good  
16 business sense now.

17           But I could chose to negotiate with another  
18 CRS who might possibly make my agency a better offer.  
19 Would I take it, maybe. But that's my decision, not  
20 the government's. There is no problem here that  
21 warrants or justifies government involvement. Along  
22 these lines, the DOT is very focused on who owns the  
23 equipment in my agency. Again, I have to wonder if  
24 the DOT has been working on this rule so long that it  
25 hasn't seen the world change.

1           The DOT is apparently concerned about CRSs  
2 prohibiting agencies from accessing other systems due  
3 to the equipment provided by the CRS. This is yet  
4 another solution in search of a problem. Today,  
5 Stratton Travel owns 95 percent of the equipment we  
6 use, so it is not even an issue. The CRSs are quickly  
7 moving out of the equipment business. We can and do  
8 access the Internet using these computers as we would  
9 whether we owned them or the CRSs owned them. Again,  
10 there is no need for the DOT to regulate this.

11           Fourth, access to information -- I can serve  
12 my customers better when I have access to the fares  
13 and the flights that they want. My customers want to  
14 chose from the full array of fares offered by the  
15 airlines, although, most of the major airlines have  
16 declined to give them to me. In the last year, two  
17 CRSs have been trying to get all the fares from the  
18 airlines by offering discounted booking fees to the  
19 carriers. It's a win, win, win. To the airlines to  
20 reduce their booking fees, to the CRSs who have access  
21 to the full complement of fares and to the travel  
22 agencies and their customers who can actually get  
23 those fares through the channel they prefer.

24           As a Sabre subscribers, I'm extremely  
25 pleased that U.S. Airways and United Airlines have

1 signed agreements with Sabre that give my agents  
2 access to all of their fares through the system that  
3 they use every day. I sincerely hope other carriers  
4 will follow that example.

5           Incredibly, in this proposal, the DOT seems  
6 to want to exacerbate the problem of limited access to  
7 fares. It is encouraging consumers to go to the  
8 Internet to buy their tickets from the airline Web  
9 sites or Orbitz. Why would the government want to ban  
10 contracts that would give me wider access to fares  
11 through the CRS that I use. The marketplace could  
12 work to solve this problem. United and U.S. Airways  
13 have signed with Sabre. United, U.S. Airways, and  
14 Continental have signed with Galileo.

15           Unfortunately, the simple fact that this  
16 NPRM is pending is chilling the marketplace and  
17 serving as a disincentive for other carriers to make  
18 the same arrangement. And that makes me wonder who  
19 this NPRM is designed to benefit, consumers or  
20 airlines? In this challenging time for our industry,  
21 the Department has an historic opportunity. It can  
22 recognize the dramatic changes that have occurred in  
23 travel distribution since the CRS rules were first  
24 adopted in 1984, and indeed, be even more significant  
25 changes in the marketplace since this rulemaking began

1 in 1997.

2           Instead of imposing CRS rules that are out  
3 of touch, the government should regulate the CRS  
4 industry now. It should recognize that airlines are  
5 out of or getting out of the CRS business. It should  
6 commit to rigorous enforcement of anti-trust laws to  
7 prevent the airlines from getting back in. By taking  
8 these steps, the DOT will be assuring the very best  
9 outcome for all the parties involved -- travel agents,  
10 airlines, CRSs and most importantly, consumers. Thank  
11 you.

12           MR. REYNOLDS: Okay, if the Department or  
13 other agencies rely upon enforcement actions, is there  
14 a risk of inconsistencies in a case-by-case approach?

15           THE WITNESS: Now I suppose that's possible.  
16 But, you know, you'd have to give credit to the  
17 travel agency community. We're far savvier. We're  
18 far wiser than most of the people in this room give us  
19 credit for. We're the advocate for the consumer and  
20 we would look and be able to see through that and to  
21 go to the best channel to service our clients.

22           MR. REYNOLDS: And I gather under complete  
23 deregulation, you would be fine if display bias was  
24 not regulated as well?

25           THE WITNESS: You know, that's not my



1 decision to make, but again, I think you would have to  
2 give credit to the professional travel agent who is  
3 aware of what a bias situation is. We have lived with  
4 in the past. We have lived without it now. And a  
5 good travel agent can see through all of that.

6 MR. REYNOLDS: Okay, thank you very much.  
7 Next Interactive Travel Services Association.

8 THE WITNESS: Good afternoon. Thank you for  
9 the opportunity to participate in this important  
10 hearing. My name is Antonella Pianalto. I'm the  
11 executive director of the Interactive Travel Services  
12 Association, ITSA. Founded in 1998, ITSA's mission is  
13 to promote consumer choice, access, competition and  
14 independence in Internet travel distribution.

15 Time and again, the Department of  
16 Transportation has emphasized the need to protect  
17 consumers and competition when it comes to travel  
18 distribution. ITSA wholeheartedly agrees with this  
19 need. That is why we've been very concerned about  
20 supplier-Internet joint ventures. And in particular,  
21 most favored nations clauses that limit independent  
22 travel distributors ability to provide choice and  
23 access to consumers.

24 As recently as April 2002, when the draft of  
25 the NPRM gets sent to OMP, the Department said we have

1 seen too many cases of apparent anti-competitive  
2 action by airlines owning or marketing a system to be  
3 willing to give them free reign. Indeed, it was the  
4 anti-competitive conduct of a few airlines that lead  
5 to the introduction of the CRS rules in 1984. Yet,  
6 the Department's proposed rule would have the effect  
7 of giving the airlines joint venture Orbitz a free  
8 reign at the expense of consumers.

9           At the same time, DOT proposes a two-pronged  
10 approach that adds regulations to the existing CRSs,  
11 but takes a hands-off approach to CRS-like activity by  
12 airline-owned Internet services. In a word, this is  
13 simply quite wrong.

14           In reviewing the numerous comments submitted  
15 to the docket in March, it denotes the overwhelming  
16 number of organizations that share our opposition to  
17 the NPRM and the selective exemptions it creates.  
18 Consumer groups, business travelers, travel agents,  
19 low-cost carriers, CRSs and think tanks agree that the  
20 NPRM is the wrong approach for the travel distribution  
21 market and would have a negative effect on  
22 competition.

23           In addition, members of Congress, the SPA  
24 Office of Advocacy, and NFIB have expressed concerns  
25 about the particular impact the NPRM will have on

1 small businesses. ITSA takes special note of Orbitz's  
2 self-serving comments in its initial NPRM filing as  
3 one of the few organizations to support the NPRM.  
4 Orbitz offers the distorted view of the current travel  
5 distribution marketplace, both online and offline.  
6 ITSA strongly opposes the illogical view that the DOT  
7 should approach deregulation by first enacting a  
8 series of new rules which would apply to everyone  
9 except Orbitz.

10           Understandably, Orbitz conveniently ignores  
11 the historical abuses of CRS systems by its owners.  
12 Throughout its comments Orbitz also completely ignores  
13 its own airline ownership. It also ignores the hugely  
14 significant market power of its owner's 75 percent  
15 control of the U.S. airlift. It is ludicrous to  
16 purport that the same U.S. airline that in the past  
17 used CRSs to eliminate competition are trying now to  
18 increase competition through a collaborative joint  
19 effort.

20           In truth, the online travel industry was  
21 highly competitive, innovative and produced  
22 deficiencies long before the airlines formed Orbitz.  
23 In its 1999 yearbook, Focus writes the online travel  
24 marketplace researcher describes the online travel  
25 marketplace as "crowded and highly competitive where

1 new services are launched almost weekly." Then in  
2 late 1999, the airlines announced the formation of T2,  
3 now known as Orbitz.

4           So what does the marketplace for online air  
5 travel look like now? Competition has been reduced.  
6 There are fewer sites now than before Orbitz launched.  
7 No new serious online travel sites have entered the  
8 market and major players have exited. Forester  
9 researcher's prediction in its January 2000 brief was  
10 on target when it said, and I quote, "Here's what T-2  
11 presence will do to the market. The consumer travel  
12 window will slam shut. It's over. With the entry of  
13 this new, heavy-hitter, there is no more room for new  
14 entrance into the consumer facing online travel space  
15 in the U.S."

16           Orbitz describes a competitive distribution  
17 marketplace as one where supplier and distributors  
18 negotiate terms and costs. Yet, in Orbitz's case, the  
19 suppliers own the distributors. There is no arm's  
20 length negotiation. Instead, it's airline owners  
21 collectively and collusively set the terms, including  
22 their own mandatory participation and the Fed rule and  
23 the cost of distribution.

24           MR. REYNOLDS: Excuse me, but aren't online  
25 travel agencies getting more and more access to

1 airline web fares?

2 THE WITNESS: Yes, I'd say since the  
3 Department of Justice and the Department of  
4 Transportation started seriously investigating Orbitz,  
5 the airlines have been a little bit more willing to  
6 negotiate. But as you heard earlier today, not with  
7 all online travel agencies. And the deals that some  
8 of them have been able to get are far less  
9 comprehensive than the deal that Orbitz has with its  
10 airlines.

11 MR. REYNOLDS: Do you believe that online  
12 travel agencies have lead to a decrease in market  
13 power or bargaining power of the CRSs?

14 THE WITNESS: Market power in terms of  
15 bargaining with the airlines has certainly been  
16 decreased since Orbitz. So I'm not sure.

17 MR. REYNOLDS: So there was no decrease  
18 before Orbitz of the bargaining power?

19 THE WITNESS: The online sites had a lot  
20 more bargaining power with the airlines before Orbitz  
21 than they do now.

22 MR. REYNOLDS: I'm speaking of the power  
23 between the CRSs and the airlines?

24 THE WITNESS: The issue has to do with some  
25 of the online sites with access to fares. And there

1 wasn't an issue of access to fares that there is now  
2 since Orbitz.

3 MR. REYNOLDS: A lot of people advocate or  
4 are saying that regulations are no longer necessary  
5 because the Internet is out there as another channel  
6 of distribution. Was it having an effect before  
7 Orbitz came onto the scene? Was it acting as another  
8 channel of distribution that was affecting the  
9 relationship between the CRSs and the airlines?

10 THE WITNESS: I think I would have to say  
11 yes. Orbitz did not obtain access to web fares. The  
12 five owning airlines collectively agreed to place all  
13 their web fares in one place and collectively agreed  
14 to the price of distribution. There was no  
15 competition, no negotiation, no bargaining involved.

16 Numerous comments cites the negative effects  
17 on the marketplace of Orbitz's anti-competitive  
18 supplier joint ownership and MFM clauses, which give  
19 it an advantage that no other site can match and which  
20 facilitated its tremendous growth, which has been  
21 pointed out earlier. Orbitz has made it more  
22 difficult for independent sites to negotiate  
23 individual deals with airlines. Is model for a  
24 competitive distribution marketplace? The answer is  
25 no.

1           Orbitz contends that services have improved  
2 and prices have decreased as a result of its entry  
3 into the online marketplace and wants to do the same  
4 for the CRS marketplace. Yet, Orbitz provides no data  
5 to support this assertion. MIT Economics professor,  
6 Jerry Houseman, on the other hand, provides  
7 statistical analysis that shows because of Orbitz's  
8 MFM, prices have increased. He said this study finds  
9 that fare disbursement [sic] and the available quantity  
10 of lowest price airfares have decreased significantly  
11 Orbitz began operation, which is the expected effect  
12 of the MFM clause contained in the Orbitz agreement  
13 and which is harmful to consumers."

14           Orbitz purports that before it entered the  
15 market other sites were not consumer focused. Nothing  
16 could be further from the truth. Independent sites  
17 have always been consumer focused, not airline focused  
18 like Orbitz. Independent travel distributors have  
19 negotiated deals on behalf of consumers to keep prices  
20 down by forcing suppliers to compete and by  
21 introducing innovative consumer-focused tools. Who  
22 was negotiating on behalf of consumers on a site owned  
23 by the airlines.

24           MR. REYNOLDS: Have any of the online travel  
25 agencies sold bias in their displays?

1 THE WITNESS: Sold bias?

2 MR. REYNOLDS: Or bargained for a more  
3 prominent display of fares by particular airlines in  
4 terms of displays.

5 THE WITNESS: If by bias you mean allowing  
6 airlines, and particularly, small airlines to compete  
7 and to offer what was described today as shelf space,  
8 I don't call that bias. I call that competition and  
9 that's what should be encouraged, not stopped.

10 As their comments point out, Orbitz is  
11 supplier focused, not consumer focused. When they  
12 talk about cost savings, they universally talk about  
13 the savings to the airline suppliers, not to  
14 consumers. As nearly every major consumer group in  
15 the country has repeatedly said over the last three  
16 years, a site owned by five of the major U.S. airlines  
17 does not have the consumers best interest in mind. Is  
18 this the model for a competitive distribution  
19 marketplace? The answer is no.

20 It is foolhardy for Orbitz to contend that  
21 it brought much needed competition to the marketplace.  
22 When, in fact, Orbitz's owners developed a business  
23 plan that sought to slow the speed of competition in  
24 order to gain control of distribution costs. Orbitz  
25 has long wanted to corner the distribution market in



1 the offline world in the same way it was able to  
2 negatively impact competition online.

3           The presence of the CRS rules has served as  
4 a deterrent for Orbitz selling to brick and mortar  
5 travel agents. Now Orbitz wants a free pass from  
6 government regulation. It wants the government to  
7 maintain these rules on competitors during a lengthy  
8 transition period. Is this the model for a  
9 competitive distribution marketplace? The answer is  
10 no.

11           Orbitz says it supports deregulation of the  
12 CRS industry, but only after three years of  
13 selectively regulating the CRSs. During which time,  
14 Orbitz is allowed to operate as a CRS free of  
15 regulation. A competitive marketplace is not one  
16 where the government asymmetrically regulates CRSs and  
17 travel agents while freeing the major U.S. airlines  
18 and Orbitz from regulation. Having a set of rules for  
19 some distributors while allowing a distributor such as  
20 Orbitz to operate as a CRS outside of the rule is bade  
21 policy.

22           Just as Orbitz needed the anti-competitive  
23 advantage of the MFM clause to ensure that its cartel  
24 holds together and eliminates any incentive to  
25 compete, it now wants a similar advantage in the CRS

1 market. Time and again, the centerpiece of Orbitz's  
2 distribution strategy is a regulatory exemption from  
3 DOT. DOT should reject this plea. The government  
4 should not give one player a leg up over competitors  
5 in the marketplace. Thank you for the opportunity to  
6 present our views.

7 MR. REYNOLDS: Thank you very much. Perhaps  
8 maybe one more brief break. Ten minutes we'll be  
9 right back and be able to finish with the last few  
10 presenters. We'll be back at 4:10.

11 (Whereupon, a short recess was taken.)

12 MR. REYNOLDS: Please take your seats.  
13 Thank you very much. I believe now we have the  
14 Competitive Enterprise Institute.

15 THE WITNESS: Thank you very much. I'm Fred  
16 Smith. I head CI and we're a pro market public policy  
17 organization and we've probably been involved longer  
18 than almost anyone in the area of government  
19 regulation of the CRSs.

20 Our first comment on this issue appeared  
21 back in Regulation Magazine in 1985, and we've been  
22 participating in regulatory Congressional hearings and  
23 litigations ever since. We've sued DOT in the past to  
24 have these rules overturned, earlier versions of the  
25 rules, based on commercial free speech, which we think

1 is still the position we take and we may have to sue  
2 again.

3           We've watched you today as CRS rules that  
4 were dated sunset after sunset. This past time to  
5 eliminate all these rigidities, all these regulations  
6 on this most dynamic part of the American economy.  
7 You've heard much today about the complexity of the  
8 issues, ways in which your rules might be diced,  
9 sliced, rearranged to benefit one interest group over  
10 another. And there are interest groups on all sides  
11 of this issue. You've heard a lot of them.

12           Indeed, over time, if you've been tracking  
13 this very much, some interest groups have been on both  
14 sides of the issue. Sometimes favoring deregulation.  
15 Sometimes regulation and you should expect that.  
16 Regulation distort the business landscape providing  
17 far too many temptations for businessmen to rush in  
18 and ask for their public interest be improved, to  
19 lobby the rules that will tilt the playing field in  
20 their direction.

21           Hearing such as this can be thought of as  
22 feeding fields for the rent-seeking community. But  
23 DOT, your responsibility is protect the consumer  
24 welfare, not airlines, not CRSs, not travel agents,  
25 not Orbitz, not anyone else, the consumer interest

1 alone. That means also you should avoid rushing in to  
2 try to second guess time tracks, bundling, unbundling,  
3 tying, integration, spinoff, cost base versus value  
4 base, pricing policies and so on.

5           As Ronald Coates and other economists have  
6 long noted, the institutional arrangements, both  
7 within and between firms, are one of the most  
8 difficult and creative elements of an economy and to  
9 try to guess that from before is impossible. You lack  
10 the data. You lack the competence. And you really  
11 lack the incentive structure to do that as effectively  
12 as the market will. Competition through the  
13 marketplace is by far the best way of advancing  
14 consumer interest for ensuring their future is a good  
15 one.

16           Let me tell you a little bit of the history.  
17 The CRS rules, after all, arose during the confusion  
18 over the initial airline deregulation, the early '80s.  
19 At that time we were finally fraying out the  
20 transportation industry from, in some cases, a hundred  
21 years of government interference. And as we  
22 deregulated, most of the airline part of the air  
23 travel industry -- we tragically did not do anything  
24 about the airports or the air traffic control system.  
25 We rushed in and regulated the most innovative, the

1 most dynamic subsector of the airline industry, the  
2 computer reservation system. My article was called  
3 From the Mummy's Tomb, which argued that as we were  
4 closing up this bad crypt of regulation, we reached  
5 out and grabbed the throat of the innovative part of  
6 the industry.

7           This was partially a misclassification  
8 problem. When DOJ was asked to deal with this issue,  
9 it came about through looking at it as a regulated  
10 industry, monopoly power, all those kinds of things.  
11 So it got classified as an antitrust, a competition  
12 question. Had that arisen out of what it was, we  
13 believe, an information question, a newspaper  
14 question, a commercial speech question, we think most  
15 of the CRS regulations would never have made it into  
16 reality because commercial speech has a very strong  
17 requirement before you regulate it, and we think those  
18 restriction have been largely avoided, abated in the  
19 CRS area.

20           What has been the result of those  
21 regulations?

22           MR. REYNOLDS: Excuse me, do you believe  
23 then that there was never any abuse at all of market  
24 power by the airlines when owned the CRSs vis-a-vis  
25 their competitors?

1                   THE WITNESS: We believe that in the  
2 frontier part of the economy, the dynamic part of the  
3 economy where someone gets there first and tries  
4 things, there are always disequilibriums situations.  
5 We think those disequilibriums situations create the  
6 incentives to quickly resolve them. And that the  
7 worst thing we can do is try to freeze those momentary  
8 bubbles on the marketplace with rigidities that freeze  
9 them forever. No, we do not believe that there was  
10 any reason at all to initiate regulations to the CRS.  
11 We made that argument back in the early '80s. We  
12 made it in the administration. We lost but we're  
13 going to try to make it again.

14                  MR. REYNOLDS: So you believe in principle  
15 it was wrong, but that there may have actually been  
16 abuses?

17                  THE WITNESS: No, I think that there  
18 situations that are inevitable. Someone always gets  
19 to the marketplace first. And when they get their  
20 first, they have the market power. There's no  
21 competition. Yes, they abuse that market power if  
22 they exploit that temporary situation. They  
23 accelerate other goods coming in, disciplining them.

24                  Bill Gates just pointed out that he can  
25 always raise the price of everything this year, and in

1 two years he might well find himself out on the  
2 streets. Markets disciplines by creating -- if you  
3 create market power and abuse that market power, you  
4 more quickly accelerate the corrective forces in the  
5 market. So, no, we do not think there was any reason  
6 to regulate and there certainly is no reason to  
7 regulate now with all the changes that have occurred  
8 since.

9 MR. REYNOLDS: Do you have sense of what  
10 would have come in to get around the abuses?

11 THE WITNESS: Well, it's done harm in three  
12 areas. Let me quickly get to that. It harmed the  
13 airline industry. Essentially, one of the reasons the  
14 airline industry is in some disarray today is because  
15 we made it hard for it to exploit what, after all,  
16 seemed to be the most promising portion of the airline  
17 industry at that time. Airlines and other industries  
18 are continuously shrinking, expanding, rooting out  
19 horizontally and vertically. One of the ways you  
20 become a more profitable industry over time is to rush  
21 into the areas that are more profitable. In this  
22 case, what became the Internet marketing world.

23 The airlines had a CRS beach head. The  
24 first Internet marketing tool in the world, but they  
25 were blocked from doing much with it. United had an

1 attempt to integrate downward into hotel and auto  
2 services, went to a hearing, was blocked in that area.  
3 That avenue expansion of the airline industry was  
4 closed off. That business plan was destroyed. When  
5 you exclude any part of the industry from the most  
6 rapidly growing part of the economy, you limit its  
7 ability to survive and be profitable.

8           It also weakened the evolution of the CRS  
9 itself. You asked where they might evolve. When I  
10 was debating this back in the '80s, I remember one  
11 time going over one day saying, okay, they maybe  
12 stupid regs, but what's going to be the point? Who  
13 cares? What are they really restricting? I said I  
14 don't know, maybe in the future some new entry airline  
15 would want to come on the display screen and having  
16 flashing lights and booming things and streamers going  
17 around. He said computers can't do that. I said I  
18 know but maybe some day they can. Well, it turns out  
19 they might have much more quickly had we not regulated  
20 it and they might never have done that on the Internet  
21 had we continued to regulate other parts of the  
22 economy.

23           They also, I think, slowed the whole  
24 evolution of E-Commerce in our country by encouraging  
25 regulators and legislators to look for suspicion on



1 the whole E-Commerce world. The most, I would argue,  
2 dynamic part of the economy. They basically  
3 encouraged other groups to think carefully before  
4 expanding too rapidly. If the fastest horse on the  
5 track is crippled, other horses are somewhat reluctant  
6 to rush out and race.

7           Some points -- DOT proposed rules expressed  
8 outmoded concepts of monopoly. They ignore the games  
9 that are possible through integration in the other  
10 business practices I talked about. That was some  
11 points we've made throughout our testimonies in the  
12 past. We've gotten them in our written comments.

13           People have talked about the changes that  
14 were seen from '92 to the present day, or maybe before  
15 the present day. And you've heard a lot of worries  
16 and fears, but not much evidence. You've been asking  
17 for it all day and you haven't heard much, have you?  
18 Why should we rush in to regulate when there's been no  
19 real evidence of abuse?

20           That market power, market failure somehow  
21 conceptually justifies government intervention when  
22 also recognize the government institutions themselves  
23 are fallible. Government pencils have erasers on them  
24 just like private sector pencils do, and to assume  
25 that a government intervention will correct whatever

1 arguments one might or might not raise about market  
2 power, market failure, is, at least, speculative.

3           Check consumer harm. You've heard no  
4 evidence of consumer harm. You've heard a lot of  
5 businessmen who are mad at each other, but so what?  
6 That's not the purpose of America. The purpose of  
7 America is to help the citizenry, the consumers, not  
8 one business sector over another. Historically, of  
9 course, the case of CRS regulations were this so-  
10 called display bias. The argument that if you hadn't  
11 rushed in, one airline might have been benefitted over  
12 another.

13           You know, when I wrote my paper on this, I  
14 made the analogy to supermarkets. I mean, think about  
15 a supermarket as a series of display shelves where you  
16 put the incredible array of products that characterize  
17 the better marketplace. It's one of the most  
18 difficult things to imagine.

19           I mean, imagine you've got an empty  
20 supermarket. There's 20 or 30 trailer trucks lined up  
21 out there. The guy comes up to you and says, okay,  
22 buddy, where do you put it? Then there is shelf  
23 policy, price policy. We use information massively in  
24 the supermarket area. You've heard a lot about is it  
25 right to allow information sharing in this industry.

1           One of the greatest consumer benefits we've  
2 achieved in the electronic world is the ability of  
3 supermarkets to gain information that allows us to  
4 more correctly target sales displays, reorder  
5 policies, et cetera. The same thing is true in the  
6 airline industry. Nothing should be done to eliminate  
7 the benefits that are coming about by the reduced  
8 costs of information acquisition and information  
9 processing. This is one of the most important  
10 consumer benefits this generation can realize and any  
11 attempt to restrict that will only restrict consumer  
12 welfare. There's a lot we can say about that. You  
13 know some of this stuff.

14           Let's see, others have told you about the  
15 rules and what they talk about how we should talk  
16 about and display service fees. The regulations state  
17 that service fees have to be -- in some listed  
18 separately and you've got a whole series of sub-  
19 degrees and what you do about that. Those are how you  
20 display information, again. And again, information  
21 displays are protected by commercial free speech  
22 concepts. A must higher standard of regulation than  
23 Gordon grade, economic regulation. Where you should  
24 put on the page of a newspaper prices, quantities,  
25 service information is something that I would hope you

1 would never touch. And yet, you are seemingly  
2 unwilling to rush into this area when you're dealing  
3 with electronic display systems. The electronic  
4 display screens are just the newspapers of tomorrow,  
5 and you ought to use them in a much more sensitive  
6 way.

7           The question about whether there's some  
8 confusion here, anyone who's gone to New York City  
9 likely knows how confusing it is to know what you're  
10 actually going to end up paying. You go in there and  
11 you've got a rack rate of \$150 or \$200 and then you  
12 end up with what, two, three, four service fees,  
13 taxes, recreational services charges and so on. It's  
14 not always obvious to know what you're getting paid  
15 there, and yet, we still go to New York City. And  
16 travel agents actually can play a good role in helping  
17 you save.

18           You talk about helping travel agents. At  
19 least some of these rules are in the benefit of the  
20 travel agency, but you would prohibit any airline from  
21 providing its flight software that would favor one  
22 airline or another, even if the travel agent was in  
23 favor of that. Yet, showing results in a preferential  
24 manner is the lifeblood of such very successful  
25 Internet agents as Yahoo and Google.

1           Banner ads pop all the time. They pay for  
2 hosting, which allows your information to come up  
3 earlier than others. And it's one of the reasons that  
4 those search engines that have become viable, so  
5 important and we as consumers aren't being exploited  
6 in that case. We benefit dramatically from the  
7 information displayed and we can quickly scroll down  
8 if it's not our choice at the top of the list.

9           Travel agents are vastly more sophisticated.  
10 Search engines on top of search engines than most of  
11 us are, and they're well able to navigate CRS screens.  
12 They really don't need government to tell them how to  
13 go through the electronic pages, yellow pages. So be  
14 careful.

15           When you do this, you're basically talking  
16 about regulating commercial speech. Last time,  
17 incidently, we did not win our case. We got knocked  
18 out for standing. We had a travel agent who was with  
19 us, but we couldn't get anyone in the CRS area to  
20 point out any area where their speech had been  
21 restricted. At that time, the airlines still owned  
22 the CRSs. I don't think we'll have so much trouble  
23 getting someone if this issue comes up again.

24           CI supports the view that DOT does not --  
25 that you may well lack the authority to regulate.

1 Certainly, the authority to regulate once you've had  
2 all the spin offs you have of ownership and so on.  
3 And certainly, in areas that have nothing to do with  
4 the airlines or the travel agency. When divested of  
5 airline control, a CRS is neither an air carrier nor a  
6 ticket agent. Airlines offer tickets for sale, travel  
7 agents sell tickets. CRSs are merely the  
8 E-bays of the electronic airline world.

9           It would be unthinkable to seek to regulate  
10 E-bay or Yahoo simply because the goods it sells over  
11 its electronic auctions happen to be regulated  
12 themselves. You can't expand a regulatory power based  
13 on the fact that something that touches this industry  
14 happens to be regulated. So what do I suggest you  
15 guys do? You've been regulating this industry since  
16 1984. You did a wonderful job in 1978 of freeing up  
17 parts of the airline industry from regulation.

18           You made a big mistake, or your predecessors  
19 made a big mistake in regulating in '84, expanding  
20 that regulation or continuing that regulation in '92  
21 and '97. You're now looking at that question for  
22 what, the third time. Any transitional rules will  
23 just perpetuate themselves into the future. Any  
24 regulations will continue the consumer harm you've  
25 already been doing for the last almost 20 years.

1           You know, Oliver Cromwell once went to  
2 Parliament after a while and he came into the hall and  
3 he said, gentlemen, you have been sitting long enough.  
4 Go home. I would recommend that, gentlemen, you've  
5 been regulating long enough. Stop regulating. Thank  
6 you.

7           MR. REYNOLDS: Thank you very much. I  
8 believe, next, we have the Progress and Freedom  
9 Foundation.

10           MR. ADKINSON: Thanks very much. My name is  
11 Bill Adkinson, and I'm senior policy counsel for the  
12 Progress and Freedom Foundation. We are a private,  
13 nonprofit, nonpartisan, research institution  
14 established to study the digital economy and digital  
15 revolution and its implications for public policy.

16           PFF has examined the explosion of online  
17 travel distribution services and specifically  
18 investigated the CRS regulatory proposals and the  
19 controversy surrounding Orbitz. Of course, I speak  
20 only for myself and not for PFF or its officers.

21           An overview: My comments examine the  
22 Department's basic approach to CRS regulation,  
23 addressing two broad issues. The first is whether  
24 there are justifications for continuing the  
25 regulations, and the second is considering what the

1 costs are.

2           My central message is this: Relying on  
3 competitive forces in the CRS service market, backed  
4 up by the antitrust laws and other related  
5 protections, will best serve consumers and the entire  
6 air-travel industry. Market forces are fully  
7 sufficient to discipline CRS conduct, and continued  
8 regulation will impose unacceptable drags upon  
9 innovation in this dynamic marketplace and put  
10 artificial barriers on competition between the  
11 traditional channels and the new distribution channels  
12 that are arising online.

13           In addition, I would emphasize that digital  
14 technologies, first, CRSs and then Internet-based  
15 distribution, has brought enormous benefits to  
16 consumers and to this industry. Protecting the  
17 freedom to innovate and to adapt to the changing  
18 environment is essential if consumers are to continue  
19 to receive the maximum benefit possible. Regulating  
20 CRSs, and, particularly, the repeated extension of  
21 these regulations during the last five or six years,  
22 has unduly burdened innovation.

23           I would emphasize that as these proceedings  
24 and, indeed, these hearings show, there is enormous  
25 tenacity in support of the existing regulatory order,



1 even in the face of clear evidence that things have  
2 changed dramatically, and regulation should be  
3 abandoned. It is very difficult to change a  
4 regulatory order.

5 I, in particular, want to point out that you  
6 can always make a case for the idea that there is some  
7 market imperfection over there that requires some  
8 regulatory intervention, or there is some reason for  
9 delaying the study further, the developments in the  
10 market, and that can result in five-and-a-half-year  
11 proceedings to consider changing a regulatory system.  
12 It's important that the Department act definitively  
13 and act now to change this set of presumptions, to  
14 deregulate and then allow people who believe sincerely  
15 that certain protections need to be placed in the  
16 system argue for such changes rather than imposing  
17 this entire structure waiting to evaluate whether  
18 individual items should be adopted.

19 MR. REYNOLDS: If we were to deregulate,  
20 doesn't the enforcement method of disciplining or  
21 monitoring the marketplace run the risk of  
22 inconsistencies from a case-by-case basis?

23 MR. ADKINSON: It can if it's truly case by  
24 case as opposed to issue by issue. I think it's  
25 important often if you have several complaints from

1 travel agents about a particular kind of problem to  
2 try to develop a mechanism where that is considered on  
3 some sort of more global basis that recognizes it as a  
4 pattern and thereby address. I think there are  
5 regulatory mechanisms for dealing with that  
6 effectively.

7           Finally, I would note that imposing some  
8 sort of interim or temporary regulations, I think, is  
9 doomed to failure because I don't think they will be  
10 interim or temporary; I think they will last for quite  
11 a long time because there just will be continued  
12 desire to have further investigation, further  
13 consideration, and the like.

14           In considering the specific question of  
15 whether there is a continuing justification for the  
16 regulations, I would emphasize that the NPRM tends to  
17 make rather broad and conjectural statements about the  
18 existence of market power and reliance, to a large  
19 extent, on facts or analyses from the 1992, or even  
20 from the 1984, proceeding. I think they are outdated.  
21 I think they also mistake what may be potential  
22 bargaining advantages for CRSs for market power. In  
23 particular, there is a concern that the airlines may  
24 be caught in a situation where CRSs have market power  
25 against them, according to the NPRM.

1           I think this misses key elements of  
2 competition in the marketplace. First, airlines  
3 themselves can exercise bargaining power through  
4 controlling information for flights, for example.  
5 Now, it's true that for some time they have been  
6 inhibited from exercising that sort of control because  
7 of the mandatory -- rules and because of the  
8 nondiscrimination requirements, but DOT has correctly  
9 seen that problem and proposed to deal with it; and,  
10 therefore, I think airlines will be able to flex their  
11 muscles in the marketplace.

12           MR. REYNOLDS: Do you believe that in 1984,  
13 1992, and the earlier circumstances that there was  
14 market power being used in an anticompetitive fashion  
15 through the CRSs between the airlines among themselves  
16 and the larger ones against the smaller ones, for  
17 example?

18           MR. ADKINSON: I can't really transport  
19 myself back. I certainly think, from my reading of  
20 the '92 proceeding, that there was a mistake, that  
21 there was a tendency to view what I would see as  
22 simply market advantages from being there first or  
23 being there in a more effective manner. So I would  
24 say my answer is I don't believe so, but, in any  
25 event, I think there is really excessive reliance in

1 the current NPRM on references to what was believed to  
2 have been going on in those times.

3 I think that this marketplace is very  
4 different. This marketplace has got half of the  
5 tickets now being bought through traditional travel  
6 agents. There's reports in the Wall Street Journal  
7 this week about projections of increased Internet  
8 distribution of airline tickets. I really think that  
9 trying to look back that far is a mistake. There is  
10 just too much that's difficult to understand going on  
11 in the market today.

12 Moving on, in fact, I would say this  
13 proceeding provides a shining example of how  
14 innovation simply outpaces regulation. During the  
15 pendency of this proceeding, we've seen the rise of  
16 Internet distribution, we've seen the divestiture of  
17 most of the CRSs by airlines, and if the WORLDSPAN  
18 deal goes through, the lion's share of CRSs divested.  
19 DOT correctly called a recess in midstream and looked  
20 at these issues, but even since then, there's just  
21 been continued developments, the continued increase in  
22 online sales. Orbitz is now looking at a service to  
23 provide travel agents information in a more direct  
24 form and is also looking at direct connect with the  
25 airlines.

1           I think in all of these developments, no  
2 matter how the Department tries, and it's doing as  
3 good a job as can be done in this regard, it's just  
4 impossible to keep up with this marketplace; it's too  
5 dynamic. The right lesson is to remove the shackles  
6 that the regulations impose on this process.

7           MR. REYNOLDS: Do you believe that the  
8 Department lacks the legal authority, or is it just a  
9 matter of policy?

10          MR. ADKINSON: I believe one of the examples  
11 of tenacity in the face of clear evidence for  
12 deregulation is the effort to view CRSs as travel  
13 agents. I don't think there is much to that argument.  
14 Also, I don't think someone would make that argument  
15 but for a strong desire to retain the status quo set  
16 of regulations. It's a good lawyer's argument, I  
17 guess, and I respect it, but I think it really shows  
18 how tenacious the status quo is and why it's important  
19 to take action now and take decisive action now.

20          MR. REYNOLDS: Thank you very much.

21          MR. ADKINSON: Thank you.

22          MR. REYNOLDS: Next, I believe from  
23 Mercatus.

24          MR. COCHRAN: Mr. Deputy Assistant  
25 Secretary, ladies and gentlemen, thank you for the

1 opportunity to comment on the continued applicability  
2 of the CRS rules. I am Jay Cochran, C-O-C-H-R-A-N,  
3 research, development, and regulatory studies at the  
4 Mercatus Center at George Mason University; adjunct  
5 professor of economics at GMU. I authored our comment  
6 that we submitted earlier this spring on the proposed  
7 rule, on the notice of proposed rulemaking.

8           Our mission at the regulatory studies  
9 program is to advance the knowledge of the impact of  
10 regulations on society by conducting careful,  
11 independent analyses using contemporary economic  
12 scholarship to assess rulemaking proposals from the  
13 perspective of the public interest. Thus, the written  
14 comments I submitted, as well as my comments today on  
15 the proposed rule, do not represent the views of any  
16 particular affected party or special interest group  
17 but, rather, are designed to evaluate the effects of  
18 the Department's proposal on overall consumer welfare.

19           I would like to emphasize for the record,  
20 however, that the views I express today are my own and  
21 do not reflect those of George Mason University.

22           The previous speaker alluded to a citation  
23 in this week's Wall Street Journal -- it was actually  
24 Tuesday, the 20th, page A-13 -- which cites the study  
25 that's been bandied about today all day from Jupiter

1 Media, which says that including -- I'm just  
2 excerpting here -- including managed business travel,  
3 in addition to leisure and nonmanaged business travel,  
4 the Internet will generate 30 percent of all ticket  
5 sales. In 2002, online ticket revenue was \$16.8  
6 billion, or a 28 percent market share, so there is  
7 some of that statistical information.

8 In its announcement of this public hearing,  
9 the Department sketched four questions on which it was  
10 seeking input. One: Are the CRS rules governing  
11 system operation still necessary? Two: Should the  
12 mandatory participation rule be eliminate? Three:  
13 Should the CRS rules restrict whether marketing and  
14 booking data generated by the systems may be obtained  
15 by the airlines? And four: Should the CRS rules  
16 restrict contract practices between the systems and  
17 travel agencies?

18 In answer to the first question, whether the  
19 CRS rules governing system operation are still  
20 necessary, I submit that whatever basis the CRS rules  
21 may have once had has long since evaporated, for two  
22 principal reasons. First, a substantive divestiture  
23 by the owner airlines has obviated potential market-  
24 power arguments that underpin the original rule.  
25 Second, and perhaps more importantly, CRSs today do

1 not enjoy meaningful market power that cannot be  
2 effectively checked through alternative flight-booking  
3 venues, such as Internet-based travel sites or by  
4 going directly to the airlines themselves, either by  
5 the Internet or through telephone, for example. In  
6 addition, continued industry innovation offers yet  
7 another check on any latent CRS market power that may  
8 exist.

9           In short, whatever economic rationale may  
10 have existed for the rules two decades ago almost  
11 certainly no longer exists today.

12           With respect to the remaining three  
13 principal areas of Department concern mentioned in the  
14 letter, that is, mandatory participation, marketing  
15 and booking data to the airlines, and travel agency  
16 contract terms, I would suggest that these can be  
17 conveniently grouped as different manifestations of a  
18 generalized attempt to regulate contract practices  
19 between competent, self-interested parties, and, as  
20 such, any restrictions in contract terms like these  
21 will tend to be self-defeating, and this is so for  
22 several reasons. Principally, though, it's because  
23 DOT simply does not know, and cannot, in principle,  
24 know, the appropriate contract terms for every party  
25 involved.



1           This should not be taken as disparagement of  
2 DOT but, rather, a simple recognition of the fact that  
3 there is simply too much dispersed localized  
4 information held by the various contracting parties  
5 which generalize terms, conditions, and regulatory  
6 prescriptions simply cannot take into account.  
7 Indeed, even if, for the sake of argument, it were  
8 possible for the Department somehow to know the  
9 appropriate contract terms today for all of the  
10 airlines, the CRSs, the thousands of travel agencies,  
11 and, by implication, the American traveling public, it  
12 is highly unlikely that such prescriptions would prove  
13 elastic enough to remain viable tomorrow, given the  
14 dynamic nature of prices, incomes, costs, and  
15 technologies.

16           The mandatory participation rule, for  
17 example, provides a concrete illustration in which the  
18 proposed rule is either superfluous or actually  
19 counterproductive. Generally speaking, it would seem  
20 airlines are likely to want the widest possible  
21 distribution of their seat inventory through as many  
22 channels as are economically feasible that is  
23 consistent with their business plans, irrespective of  
24 their ownership status in any particular CRS. If that  
25 is true, the mandatory participation rule would merely

1 be prescribing what is already likely to be a  
2 prevailing business practice among most airlines  
3 anyway.

4           Nevertheless, it is also possible that a  
5 particular airline's business model, as in the case of  
6 a startup or a regional carrier, for example, or for a  
7 larger, national carrier seeking to retrench  
8 economically, may call for a narrower distribution  
9 channel in order to control or to reduce costs. In  
10 that case, the mandatory participation rule, if  
11 adopted, could stymie such adaptive business plans  
12 except in cases where the airline's ownership of a CRS  
13 fell below the rule's arbitrary, and I stress  
14 arbitrary, five percent threshold. Rigidities imposed  
15 by rules such as mandatory participation seem likely,  
16 therefore, to add to the costs of all of the  
17 contracting parties involved.

18           The attempt to specify contract terms on  
19 booking fees and the resale of marketing and booking  
20 data present an analogous set of problems, as do the  
21 proposed rules to restrict CRS-travel agency contract  
22 practices. On the one hand, to the extent such  
23 restrictions on contracting and business practices are  
24 effective, the likely outcome will be to raise or to  
25 shift costs. On the other hand, to the extent such

1 restrictions are not total, that is, they do not  
2 consider every potential outcome and possible  
3 innovation, industry participants can be expected to  
4 innovate around the restrictions, thus rendering them,  
5 to that extent, ineffective.

6           In sum, the attempt to specify highly  
7 prescriptive contract terms, in the best case, is  
8 likely to prove ineffective, as industry participants  
9 innovate along nonregulated margins, and in the worst  
10 case, is likely to prove positively counterproductive  
11 as costs are increased and air travel is thereby made  
12 less economically attractive. Incidentally, an  
13 unintended consequence of raising air-travel costs is  
14 to induce consumers to pursue cheaper but less-safe  
15 travel alternatives.

16           From the perspective of the air-traveling  
17 consumer, therefore, it is my view that it will prove  
18 easier and far less socially costly if the Department  
19 were simply to allow the present CRS rules to sunset  
20 in their entirety. Any rationale the rules may have  
21 once enjoyed has long since evaporated, as the  
22 marketplace has moved, and will continue to move, well  
23 beyond the rule's effective reach. Thank you.

24           MR. REYNOLDS: Thank you very much. And I  
25 believe we have time for one more. Washington Legal

1 Foundation.

2           A PARTICIPANT: It looks like he didn't  
3 stick around.

4           MR. REYNOLDS: Ah, perhaps didn't think he  
5 would have an opportunity.

6           Well, thank you, everyone, for being here  
7 throughout a very interesting but long day, and we are  
8 concluded.

9           (Whereupon, at 4:45 p.m., the hearing was  
10 adjourned.)

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REPORTER'S CERTIFICATE

DOCKET NO.: OST-97-2881, OST-97-3014  
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CASE TITLE: DOT Hearing on Computer Reservations System  
(CRS) Regulations; Statements of General  
Policy  
HEARING DATE: May 22, 2003  
LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are  
contained fully and accurately on the tapes and notes  
reported by me at the hearing in the above case before the  
Department of Transportation.

Date: May 22, 2003

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